S. HRG. 99-1039

THE BANKRUPTCY ANTIFRAUD ACT OF 1986

HEARING

BEFORE THE

SUBCOMMITTEE ON COURTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

S. 2531

A BILL TO AMEND TITLE 11 OF THE UNITED STATES CODE TO MAKE NONDISCHARGEABLE ANY DEBT ARISING FROM A JUDGMENT OR CONSENT DECREE REQUIRING AN INDIVIDUAL DEBTOR TO MAKE RESTITUTION AS A RESULT OF A VIOLATION OF STATE LAW

SEPTEMBER 24, 1986

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THE BANKRUPTCY ANTIFRAUD ACT OF 1986

WEDNESDAY, SEPTEMBER 24, 1986

U.S. SENATE,
SUBCOMMITTEE ON COURTS,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Mitch McConnell (chairman of the subcommittee) presiding.

Present: Senators Thurmond, Grassley, and Heflin.

Staff present: Scott Cox and Samuel Gerdano, subcommittee staff.

OPENING STATEMENT OF HON. MITCH McCONNELL, A U.S. SENATOR FROM THE STATE OF KENTUCKY, CHAIRMAN, SUBCOMMITTEE ON COURTS

Senator McCONNELL. This hearing will come to order.

This morning we are having a hearing to discuss the merits of S. 2531, the Bankruptcy Antifraud Act of 1986. This is a hearing of the Courts Subcommittee.

The bill is designed to close a rather glaring loophole in section 523 of the Bankruptcy Code. It seems that criminal defendants are now filing bankruptcy petitions in an attempt to discharge restitution orders entered against them in State courts. As a result, the victims of consumer fraud are forced to relitigate cases in bankruptcy court that should have been settled in State court.

Our Bankruptcy Code was intended to give honest debtors relief so that they could have a second chance to earn their own way in life. It was never designed to give criminals a safe haven from people whom they have defrauded.

It is also important to note that an exemption to dischargeability in bankruptcy is not unprecedented. The Congress has seen fit in the past to refuse to discharge debts incurred for child support, alimony, maintenance, and federally guaranteed student loans. The code further prohibits discharge where the debt arises from a judgment entered against the debtor for damages he or she inflicts on an innocent party while the debtor is driving drunk.

I believe that S. 2531 is needed to close this egregious loophole in the law. My colleague, Senator Grassley, is here to lead off this morning, as is Congressman Rowland from over on the House side. They both should be commended for introducing legislation that will stop this abuse of our bankruptcy system. The chairman of our full committee, Senator Thurmond, also has a statement which I would like to have inserted in the record at this point.

[A copy of S. 2531 and Senator Thurmond's statement follow:]

99TH CONGRESS
2D SESSION

S. 2531

To amend title 11 of the United States Code to make nondischargeable any debt arising from a judgment or consent decree requiring an individual debtor to make restitution as a result of a violation of State law.

IN THE SENATE OF THE UNITED STATES

JUNE 9, 1986

Mr. GRASSLEY (for himself and Mr. DENTON) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

---

A BILL

To amend title 11 of the United States Code to make nondischargeable any debt arising from a judgment or consent decree requiring an individual debtor to make restitution as a result of a violation of State law.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Bankruptcy Antifraud Act of 1986".

NONDISCHARGEABILITY OF CERTAIN DEBTS FOR RESTITUTION

SEC. 2. Section 523(a) of title 11, United States Code, is amended—

(1) in paragraph (9), as added by section 371 of the Bankruptcy Amendments and Federal Judgeship Act of 1984, is amended by striking out "or" at the end thereof;

(2) by inserting after such paragraph (9) the following:

"(10) to the extent that such debt arises from a judgment or consent decree entered in a court of record existing at the time of filing or thereafter rendered, or from a claim requiring the debtor to make restitution to, for the benefit of, or for distribution by a governmental entity as a result of a violation of State law by the debtor, or as a result of the consent decree; or"; and

(3) in paragraph (9) as in effect immediately before the date of the enactment of the Bankruptcy Amendments and Federal Judgeship Act of 1984 by striking out "(9)" and inserting in lieu thereof "(11)".

○

PREPARED STATEMENT OF HON. STROM THURMOND, A U.S. SENATOR FROM THE STATE OF SOUTH CAROLINA

Mr. Chairman, the Subcommittee on Courts meets today to hear testimony on S. 2531, the Bankruptcy Antifraud Act of 1986, which was introduced by my distinguished colleagues, Senator Grassley and Senator Denton. This bill would amend the United States Code to make nondischargeable any debt arising from a judgment or consent decree which requires a debtor to make restitution to a State, as a result of a violation of State law.

This legislation arose out of the decision in the case of *Robinson* v. *McGuigan*, in which the Bankruptcy Court discharged a State restitution debt resulting from conviction for welfare fraud. The current Code allowed the Court no other choice but to discharge the debt. The Robinson decision may set a precedent whereby debtors could be discharged from all types of restitution payments, including consumer protection restitution—as many consumer protection statutes do not require proof of common-law fraud. Other types are environmental-related restitution, as well as criminal restitution payments. State Attorneys General would be forced to either relitigate in Bankruptcy Court to prove common-law fraud or to allow the discharge to occur.

This "loophole" in the current Bankruptcy Code allows debtors to be discharged from repaying a State for gains acquired fraudulently. Senator Grassley's bill would amend the section of the Code dealing with exceptions to discharge by adding an additional paragraph which would not allow court-ordered State restitution debts to be discharged by the Bankruptcy Court.

This area of the Bankruptcy Code is very important and I commend Senator Grassley for initiating this review. I welcome our distinguished guests, Senator Grassley, Congressman Rowland of Connecticut, Attorney General Miller of Iowa, Chief State's Attorney Kelly of Connecticut, Assistant Deputy Attorney General Siemens of Kentucky, and Judge Tjoflat of the 11th Circuit Court of Appeals. I am glad you all could come before the subcommittee today, and I look forward to your testimony.

Senator McCONNELL. Now, I would like to call on my friend and colleague from Iowa, who will lead with testimony today and who will then replace me in the chair and conduct the balance of this hearing.

Senator Grassley.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator GRASSLEY. Thank you, Mr. Chairman. I said thank you privately to you before, because I know that late in a hectic session it is difficult to schedule a meeting on a bill like this. But I want to thank you publicly and I also thank you for the cooperation that your staff has given my staff in expediting consideration of this bill before this subcommittee.

Now, this issue is somewhat technical. But, nonetheless, we all know that a substantial loophole exists in the Federal Bankruptcy Code. I would like to outline the parameters of this loophole.

Under current law, a debtor is allowed to discharge in a bankruptcy any court-ordered restitution for wrongs committed. This is because the code does not expressly except restitution from discharge.

Now, essentially, this makes many State enforcement efforts meaningless. For example, after a State successfully prosecutes a consumer protection action on behalf of a "ripped off" citizen, restitution to the State is often part of the court-ordered relief.

These moneys are then distributed to the injured parties. The States recoup millions of dollars of ill-gotten gains in this way.

But the current code allows the defendant the "last laugh." He can, in a sense, thumb his nose at the State and the injured party by simply filing for bankruptcy. When the State complains, the State then is told that the code fails to explicitly except this debt.

We will hear testimony today about a recent court of appeals case where a convicted felon avoided court-ordered restitution in this way. In a separate opinion in the case, Judge Walter Mansfield of the second circuit wrote that the loophole was unintended and that the loophole ought to be filled.

I agree, and so do our Nation's attorneys general. On June 4, I received a letter signed by 15 State attorneys general which outlined the problem for them—in criminal matters, consumer fraud, and even environmental protection.

Now, the National Association of Attorneys General, at their recent conference, unanimously adopted a resolution urging congressional solution to this problem.

Mr. Chairman, I would ask at this point that the letter and the resolution be made part of that record.

Senator McConnell. Without objection, that will be inserted in the record at this point.

[Aforementioned material follows:]

Department of Justice

THOMAS J. MILLER
ATTORNEY GENERAL

ADDRESS REPLY TO:
HOOVER BUILDING
DES MOINES, IOWA 50319

June 4, 1986

The Honorable Charles E. Grassley
Chairman, Subcommittee on Administrative
Practice & Procedure
Committee on the Judiciary
Washington, DC 20510

Dear Senator Grassley:

As Attorneys General, we are keenly aware of your concerns relative to the "loophole" in federal bankruptcy law which may allow a convicted felon to avoid making court ordered restitution. *See* *Robinson v. McGuigan*, 776 F.2d 30 (2d Cir. 1985). We are in agreement that the *Robinson* decision has serious implications for state law enforcement efforts and we strongly urge Congress to remedy this problem. We fear that the *Robinson* decision could be used by debtors to discharge *all* types of restitution, including consumer and environmental-related compensation for the state, as well as criminal restitution.

The difficulties faced by our consumer protection attorneys in litigating unfair and deceptive trade practices cases graphically illustrate the problems created by the Bankruptcy Code. For some time now, our attorneys have had to do battle on two fronts in order to obtain restitution for victims of consumer fraud. First, our attorneys file petitions in state court under our consumer protection statutes. After either lengthy state court litigation or a default, consumer fraud defendants frequently seek haven at the second front, bankruptcy court, in order to avoid repayment of ill-gotten gains. Unfortunately, many of these defendants are successful in achieving their goal.

They succeed primarily because the Bankruptcy Code does not expressly designate as nondischargeable consumer fraud or any other types of restitution orders. Instead, the Code only provides that debts "for money...obtained by false pretenses, a false representation or actual fraud..." may be declared nondischargeable after the filing of a complaint and a hearing. *See* U.S.C. §§ 523(a)(2)(A) and 523(c). Courts have interpreted this exception to discharge to require proof of *common law fraud*. Although principles of collateral estoppel may apply in dischargeability proceedings, Brown v. Felsen, 442 U.S. 127 (1979), many consumer protection statutes do not require proof of common law fraud. Our offices are thus placed in the position of having to relitigate cases in bankruptcy court, proving all the elements of common law fraud, or allow the discharge to take place. Res judicata does not apply because a claim of nondischargeability is considered to be separate and distinct from a claim of consumer fraud. Id.

Allowing consumer fraud defendants to relitigate their fraud in bankruptcy court has sent a clear message nationwide. The message has been that these defendants should defend (or preferably default)[1] in state court and let the bankruptcy court decide the fraud issue anew. After a sufficient delay, the state may lack the resources necessary to pursue a mandatory dischargeability proceeding. Absent a change of venue back to the state where the fraud was committed, our attorneys are forced to travel to wherever the debtor filed. It makes no difference that these debtors have availed themselves of the privilege of doing business in our state. They have been told by the bankruptcy courts that they need not accept the concomitant responsibility.

A myriad of other roadblocks, including the expense of local counsel (or the imposition upon our fellow Attorneys General) and the unavailability of witnesses, often forecloses any hope of recovery. Because our consumer protection cases often involve hundreds or thousands of victims, each victim could be required to testify as to their reliance on the defendant's false representations and their resultant damage. If the individual claims are small, the case fails.

As if the "loopholes" noted thus far were not enough, the United States Court of Appeals for the Eighth Circuit held in In Re Cannon, 741 F.2d 1139 (8th Cir. 1984), that the Missouri Attorney General lacked standing to challenge the dischargeability of a consumer protection restitution order. Thus, the Attorney General was foreclosed from protecting the viability of a consumer fraud restitution order he had obtained. The individual victims were told to proceed alone with their dischargeability complaints. The decision in Cannon has even been used to estop Attorneys General from challenging debts which were believed to be based on fraudulent practices but which had not yet been made the subject of a consumer protection lawsuit. Our authority to enforce court orders for restitution in state consumer protection cases (and perhaps to initiate such cases after a bankruptcy filing) was annihilated by Cannon.

---

1. If a consumer fraud defendant defaults in state court, the principles of collateral estoppel cannot be applied to avoid relitigation. In this respect, the bankruptcy law actually encourages consumer fraud defendants to ignore our state court actions.

In sum, the bankruptcy law gives a green light to those who perpetrate consumer frauds or other violations of state law for which restitution to the state is a court-ordered remedy. The law either prohibits our efforts entirely or demands multiple litigation. The victims which consumer protection statutes were designed to protect are left to their own devices. Individuals cannot afford to pursue restitution on their own; nor is it cost effective for them to do so.

A simple "Exception to Discharge" amendment to 11 U.S.C. § 523 and a corresponding amendment to § 1328(a) would change the course of enforcement of restitution orders nationally.

We applaud your efforts to correct the bankruptcy law and we will assist you with this legislation in any way possible.

Sincerely,

THOMAS J. MILLER
Attorney General of Iowa

STATE OF ALABAMA
Charles A. Graddick
Attorney General

STATE OF CALIFORNIA
John Van de Kamp
Attorney General

STATE OF CONNECTICUT
Joseph Lieberman
Attorney General

STATE OF ILLINOIS
Neil Hartigan
Attorney General

STATE OF INDIANA
Linley E. Pearson
Attorney General

STATE OF MASSACHUSETTS
Francis X. Bellotti
Attorney General

STATE OF MISSOURI
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STATE OF NEW YORK
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STATE OF NORTH CAROLINA
Lacey Thornburg
Attorney General

STATE OF OHIO
Anthony Celebrezze
Attorney General

STATE OF SOUTH CAROLINA
Travis Medlock
Attorney General

STATE OF TENNESSEE
W. J. Michael Cody
Attorney General

STATE OF TEXAS
Jim Mattox
Attorney General

STATE OF WASHINGTON
Kenneth O. Eikenberry
Attorney General

Department of Justice

THOMAS J. MILLER
ATTORNEY GENERAL

ADDRESS REPLY TO
HOOVER BUILDING
DES MOINES, IOWA 50319

July 1, 1986

The Honorable Charles E. Grassley
Chairman, Subcommittee on Administrative
Practice and Procedure
Committee on the Judiciary
Washington, D.C. 20510

Dear Senator Grassley:

My fellow Attorney Generals and I wish to thank you for your efforts to amend the Bankruptcy Code by way of the Bankruptcy Antifraud Act, Senate Bill Number 2531. This bill will go a long way toward correcting a number of glaring loopholes which have thwarted law enforcement efforts nationwide. We will continue to work with you in any way necessary in order to ensure passage of this legislation.

I am enclosing with this letter the National Association of Attorneys General Resolution supporting this legislation and urging Congress to remedy the statutory "loopholes". The resolution received unanimous support at the June, 1986 conference.

Please contact me if I can be of any further assistance.

Sincerely,

Tom

THOMAS J. MILLER
Attorney General of Iowa

TJM:bac

Enclosure

Submitted by: Attorney General
Thomas Miller,
Iowa

PROPOSED RESOLUTION

BANKRUPTCY AMENDMENT

Consumer Protection

WHEREAS, state Attorneys General are charged with the responsibility of enforcing state consumer protection statutes designed to protect the public from fraudulent acts and practices; and

WHEREAS, state Attorneys General are also charged with the accompanying responsibility of recovering restitution/damages for the victims of violations of state consumer protection statutes; and

WHEREAS, the recovery of restitution/damages is an integral part of the enforcement of these laws; and

WHEREAS, the individual victims of these fraudulent acts and practices are often unable to enforce their rights because of financial or other reasons; and

WHEREAS, state consumer protection statutes were designed to allow state Attorneys General to protect just these kinds of victims; and

WHEREAS, those who perpetrate consumer frauds ought not to be allowed to discharge in bankruptcy their obligations to repay ill-gotten gains; and

WHEREAS, offices of the state Attorneys General have been plagued with increasing numbers of bankruptcy filings by those who defraud consumers and then seek haven in the bankruptcy courts; and

WHEREAS, the standing of the states to challenge the dischargeability of these restitution/damages orders remains in question; and

WHEREAS, the bankruptcy code has been interpreted to allow the discharge of state court ordered restitution/damages in consumer protection cases and/or to require litigation in both state court and bankruptcy court; and

Environmental Protection

WHEREAS, state Attorneys General are charged with the responsibility of enforcing state environmental protection statutes designed to protect the public from dangers and hazards to health and safety; and

WHEREAS, state Attorneys General are charged with the accompanying responsibility of recovering restitution/damages for clean up, etc. as a result of violations of these environmental protection statutes; and

WHEREAS, the recovery of restitution/damages is an integral part of the enforcement of these laws; and

WHEREAS, those responsible for creating health and safety dangers and hazards ought not to be allowed to discharge their restitution/damages obligations to the states; and

WHEREAS, the bankruptcy code may allow the discharge of state court ordered restitution/damages in these environmental protection cases; and

Criminal Restitution

WHEREAS, the bankruptcy code has been interpreted to allow a convicted felon to avoid making court ordered restitution; and

WHEREAS, court ordered restitution is an integral part of rehabilitation; and

WHEREAS, there is no valid reason to require the recipient of criminal restitution to file an objection to discharge in order to ensure that a restitution order will be considered nondischargeable;

Resolution

NOW, THEREFORE, BE IT RESOLVED, that the National Association of Attorneys General urges Congress to remedy these above-noted "loopholes" in the bankruptcy code by providing for the nondischargeability of debts arising from violations of State laws enforced by governmental entities; and

BE IT FURTHER RESOLVED, that the Association directs its Executive Director and General Counsel to transmit these views to the United States Congress, other appropriate agencies and officials, and interested persons.

Senator **Grassley**. My bill then, S. 2531, fills this loophole in the code. It specifically makes court-ordered restitution nondischargeable. This simple exception to discharge language makes it clear that State law enforcement and court remedies will not be made meaningless.

Mr. Chairman, I thank you very much and that concludes my statement.

Senator **McConnell**. Thank you very much, Senator Grassley for your leadership on this most important issue. We are all pleased.

I see our chairman has joined. Mr. Chairman, I had already put your statement in the record.

The **Chairman**. That is fine. I have another meeting. I just came by to pay my respects to you and to see if you had an emergency. If not, I will go to the other meeting.

Thank you very much.

Senator **McConnell**. Thank you very much, Mr. Chairman for coming by.

Senator Grassley, if you will come forward then and conduct the balance of the hearing.

Senator **Grassley**. Our next witness has arrived. The individual is Congressman John Rowland and he is from the State of Connecticut. He is the House sponsor of a companion bill. I welcome you to this subcommittee meeting and ask you to proceed. Thank you for your leadership and the cooperation that you have given.

STATEMENT OF HON. JOHN G. ROWLAND, A U.S. REPRESENTATIVE IN CONGRESS FROM THE STATE OF CONNECTICUT

Congressman **Rowland**. Thank you very much, Senator, and I want to commend you for having this hearing today and for your leadership in the Senate on this issue.

Very simply it is my opinion that Congress must amend the code to prohibit convicted criminals from skirting around court orders of restitution simply by filing bankruptcy. Unfortunately, this nefarious practice is precisely the option felons and other criminals have been given by the ruling of the Second Circuit Court of Appeals in the *Robinson* case.

As I am sure you are well aware, in the *Robinson* case, a few years ago, a New Haven woman was convicted of defrauding Connecticut's Welfare Department out of nearly $10,000 in phony payments. As part of the judgment, she was ordered to make restitution payments to the State. After making a few payments, the woman sought to simply avoid the debt by filing a bankruptcy petition.

The bankruptcy court agreed and allowed the debt to be discharged. The State attorney general appealed the decision, but the Second Circuit Court of Appeals recently overruled Connecticut's efforts at restitution. Based on the plain meaning of the Bankruptcy Code, the court really had no choice.

Mr. Chairman, to be honest, I do not believe the court wanted to rule in that way. Yet, because restitution is not listed as a nondischargeable debt in bankruptcy similar to child support payments, or back taxes or even student loans, the court was constrained to establish this precedent which has the effect of enabling criminals to avoid repaying their debt to society or to the person or persons they harmed.

In a concurring opinion, Judge Walter Mansfield termed this to be a "loophole" in the law and he specifically asked Congress to correct it. In the alternative—to quote him—"The convicted criminal will simply use bankruptcy to escape the obligation to make criminal restitution payments ordered by the court."

I agree with Judge Mansfield and that is why I introduced H.R. 3742 on November 13 of last year. The proposal, the "Criminals' Accountability Act," makes all criminal restitution orders nondischargeable in bankruptcy proceedings. Thirty-two of my colleagues in the House are cosponsors of this legislation.

As you know, on October 8 the U.S. Supreme Court will hear arguments in the *Robinson* case. In keeping with tradition, the Judiciary Committee will hold in abeyance any action on H.R. 3742 until the judicial process settles this issue.

You should know that there is somewhat of an urgency here in that the second circuit court's decision has a direct bearing right now on bankruptcy cases in my State of Connecticut as well as New York and Vermont. I will tell you that my office has received a litany of telephone calls and letters from bankruptcy lawyers all over the country who are seeking to duplicate the precedent which has been set in the *Robinson* case.

That is one reason why I do commend you for holding this hearing. The record you build today will be of immense value if Congress needs to address this loophole in the event that the Supreme Court upholds the decision of the second circuit.

One personal note if I may: Over these past few months, there has been tremendous activity in the drug abuse area. As the Nation's youngest Congressman, I felt a special responsibility to be active in our battle against drugs. And as a member of the Select Committee on Narcotics and Drug Abuse, I was involved in the bipartisan legislation which recently passed the House. And, indeed, we hope to see action taken in the Senate.

All of our efforts in this regard could be for naught given the *Robinson* precedent. Drug dealers, drug pushers, and other criminals would need only walk across the courthouse hall and file bankruptcy as they use the decision to evade their obligations to repay society for the crimes they have committed.

What kind of signal does this send? Unfortunately, to me and to all of us here, it says "crime does pay." Well, as you and I know, crime should not pay. To this end, I hope that Congress will close this loophole by enacting either H.R. 3742 or your proposal, S. 2531, into law.

At this time, I would also ask unanimous consent that my bill, H.R. 3742, be placed in the record and I want to thank you for allowing me to testify. I would be happy to answer any questions that you might have.

Senator **Grassley**. Without objection your enclosure will be made a part of the record.

[Text of H.R. 3742 follows:]

I

99TH CONGRESS
1ST SESSION

H. R. 3742

To amend title 11 of the United States Code to make nondischargeable any debt arising from a judgment or consent decree requiring an individual debtor to make restitution as a result of the commission of a crime by the debtor.

IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 13, 1985

Mr. ROWLAND of Connecticut introduced the following bill; which was referred to the Committee on the Judiciary

---

A BILL

To amend title 11 of the United States Code to make nondischargeable any debt arising from a judgment or consent decree requiring an individual debtor to make restitution as a result of the commission of a crime by the debtor.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Criminals' Accountability Act of 1985".

SEC. 2. NONDISCHARGEABILITY OF CERTAIN DEBTS FOR RESTITUTION.

Section 523(a) of title 11, United States Code, is amended—

(1) in paragraph (9), as added by section 371 of the Bankruptcy Amendments and Federal Judgeship Act of 1984, is amended by striking out "or" at the end thereof,

(2) by inserting after such paragraph (9) the following new paragraph:

"(10) to the extent that such debt arises from a judgment or consent decree entered in a court of record and requiring the debtor to make restitution as a result of the commission of a crime by the debtor; or", and

(3) in paragraph (9) as in effect immediately before the date of the enactment of the Bankruptcy Amendments and Federal Judgeship Act of 1984 by striking out "(9)" and inserting in lieu thereof "(11)".

○

Senator GRASSLEY. Congressman, thank you, first of all, for your testimony. While you are here we ought to take advantage of your study of both approaches to describe a difference between your bill, H.R. 3742, and my proposal S. 2531.

Congressman ROWLAND. Both the proposals are literally identical. There is basically only one difference—one exception. My particular proposal would apply to all debts, public and private, which result from the criminal's conviction. Your particular proposal make all debts owed by convicted criminal to a governmental unit nondischargeable in bankruptcy.

But I think, indeed, our intents are exactly the same and I would be very comfortable with either pieces of legislation moving through the process.

Senator GRASSLEY. Also, I would like to ask what, from your point of view, would happen if the Supreme Court upheld the second circuit *Robinson* opinion?

Congressman ROWLAND. Well, if the Supreme Court does uphold the decision in the *Robinson* case, I think we have to move quickly to make sure that we amend the Bankruptcy Code along the lines of either one of the two bills that we have outlined. I think what you are going to see is an avalanche of bankruptcy filings by convicted criminals. And I do not think that is the message that we want to send to criminals across this Nation.

Senator GRASSLEY. Also, you had heavy emphasis upon the urgency of passage and the correcting of this issue. Some elaboration on that point, I would appreciate.

Congressman ROWLAND. Well, the *Robinson* case is now the controlling bankruptcy precedent. Of course, that will include Connecticut and other States. I understand there are already other *Robinson* cases pending—welfare fraud filings. So that is why I make reference to urgency.

We have also had a number of phone calls with other attorneys and people seeking legal opinions and movement in that area. Our Chief State's Attorney John Kelly will soon testify and he can also elaborate as to the activity that he has seen in his office.

Senator GRASSLEY. I have no further questions, but I would ask you to keep in touch and your staff to keep in touch with my staff. Hopefully, it is not too late yet to correct this situation. I do not know whether it is possible. But, assuming the outcome of the record here has no surprises in it, I would hope that we could move shortly with passage of this legislation. Thank you very much.

Congressman ROWLAND. Thank you very much. I look forward to working with you.

Senator GRASSLEY. Now, it is my pleasure to call our first panel of witnesses. We have a very distinguished panel made up of three very good and distinguished attorneys general.

First, I would like to introduce my own State's attorney general, Tom Miller. He has been our attorney general for 8 years and has been very well received by the people. Very seldom does he have a difficult race. I want to congratulate him for his outstanding job that he is doing.

I would also call Connecticut's chief State's attorney, John Kelly, and also Gary Siemens from the Kentucky attorney general's office. And we would like to have each of you be up here together. I would like to have you testify in the order in which I introduced you and then we would have questions of the entire panel.

So, Tom, would you proceed please? And let me make clear that your entire statement, unless you say contrary, will be included in the record and you summary would be appreciated. Tom.

STATEMENTS OF HON. THOMAS J. MILLER, ATTORNEY GENERAL, STATE OF IOWA; HON. JOHN J. KELLY, CHIEF STATE'S ATTORNEY, STATE OF CONNECTICUT; AND HON. GARY E. SIEMENS, ASSISTANT DEPUTY ATTORNEY GENERAL, STATE OF KENTUCKY

Mr. MILLER. Thank you, Senator, and thank you on behalf of all of the attorneys general of the Nation for your efforts and your staff's efforts on this problem. You have obviously singled it out as a problem and are doing a lot of work on it. And we deeply appreciate this.

I speak for the 50 attorneys general. I have served for the last 2 years up until a few months as the chairman of the Consumer Protection Committee of the National Association of Attorneys General. And in this role, I have been somewhat the repository of some of the frustrations and problems in terms of dischargeability of consumer obligations in our bankruptcy courts. I have also seen a number of cases in Iowa which have made very clear to me the reasons for some of the frustrations and problems with the bankrupty law.

As you mentioned, we sent you a letter last June setting forth our position. This letter was sent by myself and a number of other attorneys general. Subsequently, we did unanimously adopt the resolution to which you also referred.

The implications of the *Robinson* case and its comparable applicability to consumer protection and environmental cases is, indeed, disconcerting. It provides in a very real way what we might call a "safe harbor" for those who would violate our criminal laws, violate our consumer fraud laws, and our environmental protection laws. It gives them a safe harbor in the bankruptcy courts because of the law as it is currently construed. I do not think that this was ever intended and I do not think that it is good public policy. I think that what was intended was quite contrary.

I think back to a Supreme Court case that is now over 50 years old that really, I think, captures the gist of what dischargeability in bankruptcy is all about. If I could just read from that Supreme Court case. The Court said:

> One of the primary purposes of the Bankruptcy Act is to "relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes." This purpose of the Act has been again and again emphasized by the courts as being of public as well as private interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.

I think the key word in here is "honest" debtor. This is really what we are looking at. And you and I have seen those situations in our home state of Iowa where, because of the crisis in the farm community, farmers have gone to the Bankruptcy Court. This is really an appropriate and effective use, and a use for which the law exists. It was not designed to provide a safe harbor for people I would characterize as con men, criminals, and polluters. But these are the kind of people who can now use the loopholes to their advantage.

What we are talking about here is nothing very radical or very sensational, or very surprising. We are saying let us add these three, and particularly these three categories which I have mentioned; the criminal restitution requirements, the consumer fraud requirements, and the environmental requirements. Let us add these to the other things that cannot be discharged which are of a very similar nature. Things like back taxes, student loans, and child support. These three things that now are not dischargeable are of very much the same nature as the three things that will be added by your legislation.

Now, it is true—and I will speak mainly about the consumer protection area in my role as past chair of the consumer committee; the others will talk more about criminal restitution—it is true that there is a provision in the bankruptcy law which says that the following debts cannot be discharged: those that relate to false pretenses, false representation, or actual fraud. You might ask, "Doesn't this provision take care of the problem?" Well, it does not because of the evolution of the law, particularly at the State level. What these terms really do is smack of common law fraud. What our States have done in a forward and progressive way over the last 20, 25 years is to move toward more of a statutory idea of consumer fraud and to remove some of the elements that really are not as applicable anymore in terms of common law fraud, yet are still very much fraud.

What we have done is modernize the fraud laws in our various States. And what has happened is the bankruptcy law freezes in the old strict outdated definition of fraud. So what you would be doing is really modernizing the Bankruptcy Code to adjust to the modernization of the consumer fraud laws in the States.

What can happen can be extremely frustrating. Take perhaps a typical example. Someone perpetrates a fraud on the citizens of a State. The State attorney general goes to court and sues the individual or individuals and gets a judgment requiring them to make restitution of the money that was really stolen from the people of that State. Then this person goes to the bankruptcy court. This is when the frustration begins.

To even have a chance to make this a nondischargeable debt, the attorney general would have to go to the bankruptcy court and relitigate the case because there are technically different elements between his statute and common law (bankruptcy) fraud.

He would, perhaps, have to go to a State that is far distant and incur added expense. He would, perhaps, have to bring in many of the consumers to prove the individual cases. There would be a tremendous waste of resources, tremendous frustration for those consumers to travel out of State to once again litigate a case that has already been litigated initially.

There has been an even more fundamental problem with an eighth circuit case which came out of Missouri—the Missouri attorney general's office. The Missouri attorney general had secured an order providing for restitution in the Missouri courts. Then the defendant went bankrupt. The case is *In Re Cannon* by the way. The attorney general proceeded to bankruptcy court to try and keep the fraud judgment alive. The court ruled that the attorney general could not do this. It ruled that he could not go to bankruptcy court to protect the rights of his citizens who he had already protected by a State court action, because he did not have standing. Only the consumers could come themselves and present their individual cases. This was extremely frustrating and ineffective for both the attorney general and the consumers.

We now have a similar case in my home State of Iowa. It is *Iowa Ventilation Company.* This company sold ventilation units for livestock facilities in our State. It sold them to about 180 Iowa farmers, charging a few thousand dollars each for the units for a total of about $1.3 million. We investigated this, found in our judgment that it was a violation of the Iowa Consumer Fraud Act, and found that the individuals recently had gone to bankruptcy court. We proceeded to bankruptcy court to try to make these debts nondischargeable. We live in the eighth circuit as you know, Senator. Very quickly, the *In Re Cannon* decision was cited to us and it was ruled that the attorney general's office could not protect its consumers in this particular case due to lack of standing.

The judge then gave the individual claimants 30 days in which to present their own individual claims. They had to go it alone. As a result, only one was able to present himself to the court in order to seek redress.

That is a story of frustration. Frustration for our office, but much more importantly, frustration for the individual citizens who have been wronged in the marketplace by consumer fraud.

We have suggested some language which perhaps will be helpful to the committee. That language is contained on the bottom of page 8 and continuing on to page 9 of our statement. This language was worked on by our office, the Connecticut attorney general's office and the Massachusetts and Texas attorney general's office. It is a suggestion for the committee.

We also would raise one other technical concern and this is that in chapter 13 many, many obligations are dischargeable. We think that some of these kinds of obligations should not be dischargeable in chapter 13 as well.

In conclusion, let me say that this legislation which you proposed and which you have taken the lead on, is legislation that is in the public interest. It serves the right people and it frustrates the right people. Now, we have a situation where the law abiding people are frustrated. Obstacles are placed in their way. Serious obstacles that usually they cannot surmount. And the benefits are placed with those who would violate our criminal laws, those who would violate our consumer protection laws, and those who would pollute our environment.

What your legislation does, and I sure hope it gets passed, is to just switch this around. It will protect the law-abiding citizen and it will frustrate the con men, the polluters, and the criminals. And this is the way it should be.

Thank you.

Senator GRASSLEY. Thank you, Tom. I appreciate that very much, in particular the experiences you have had confronting this problem.

[Mr. Miller's statement follows:]

PREPARED STATEMENT OF ATTORNEY GENERAL THOMAS J. MILLER

Senator Grassley, Mr. Chairman and members of the Subcommittee on Courts. My name is Thomas J. Miller. I am the Attorney General for the State of Iowa. I appreciate the opportunity to come here today to testify about a matter of great importance to state Attorneys General. The matter concerns a number of glaring loopholes in the Bankruptcy Code. These loopholes have thwarted law enforcement efforts nationwide. Your Bankruptcy Antifraud Act, Senate Bill Number 2531, will go a long way toward correcting these serious problems.

I speak for my fellow Attorneys General in expressing my appreciation for your leadership in this area. On June 4, 1986, I wrote to you supporting your efforts to correct the Bankruptcy law. Fourteen other state Attorneys General joined with me in this letter. In the letter, I discussed the Second Circuit Court of Appeals' recent decision in Robinson v. McGuigan, 776 F.2d 30 (2d Cir. 1985). I noted that the Robinson decision has serious implications for state law enforcement efforts in the areas of consumer protection, environmental protection and criminal law. A copy of my letter has been made a part of the record in this proceeding.

At the annual National Association of Attorneys General conference held this past summer, I sponsored a resolution urging Congress to remedy these loopholes by providing for the nondischargeability of debts arising from violations of state laws enforced by governmental entities. This resolution received unanimous support. It, too, has been made a part of the record today.

Simply stated, the Bankruptcy Code currently provides a safe harbor which shelters the fraudulent from our efforts to obtain state court ordered restitution. The Bankruptcy Code is being used by debtors to discharge all types of state obtained restitution orders, including consumer and environmental related compensation for the state and its citizens, as well as criminal restitution. Public policy and fundamental fairness demand otherwise.

The United States Supreme Court long ago stated that:

> One of the primary purposes of the Bankruptcy Act is to 'relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.' This purpose of the Act has been again and again emphasized by the courts as being of public as well as private interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy a new

> opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt. [emphasis added].

Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).

I wholeheartedly support the concept of the "fresh start" for the honest debtor. Indeed, my state has been struck hard by the troubled farm economy. The number of bankruptcy filings in Iowa has increased dramatically in recent years. These debtors deserve the protection of the Bankruptcy Code. But the Code was never meant to protect crooks, polluters and criminals.

The protection afforded these ill-deserving individuals occurs because the 11 U.S.C. § 523 "Exceptions to Discharge" statute does not close the door to the discharge of their restitution obligations. Although the law carefully excludes back taxes, student loans and child support payments from discharge, no such exception prevents the discharge of consumer protection restitution orders, environmental protection clean up orders or various criminal restitution orders.

Even though a debt for "money [or] property . . . obtained by false pretenses, a false representation, or actual fraud . . ." may be excepted from discharge, 11 U.S.C. § 523(a)(2)(A), the majority of courts have repeatedly held that "actual fraud" and not simply "fraud implied in law" is required for this exception to apply. [Emphasis added]. Although the language of the Code appears to adequately address consumer fraud, the courts have interpreted the statute to require a higher standard, one which is inconsistent with current consumer protection statutes.

For twenty years, state consumer protection statutes have been drafted to eliminate some of the legal elements of "actual fraud." Our legislatures have viewed "consumer fraud" as a specific kind of unlawful act and have set appropriate legal standards. A judgment for restitution obtained under our statutes, however, is rendered useless if the violator seeks the protection of the Bankruptcy Court. Our attorneys are consequently required to relitigate cases which have already been successfully prosecuted. Consumer protection attorneys are, of necessity, transformed into bankruptcy lawyers.

Our offices are forced to file "Complaints to Determine Dischargeability" in whatever state the debtor happens to file his or her bankruptcy petition. Victims, if willing and able, may be required to travel across the country to testify a second time as to the defendant-debtor's illegal acts. Scarce resources for state consumer protection cases are depleted by out-of-state travel expenses and all other expenses associated with a second court action.

An even more serious problem for state law enforcement may be presented by the holding of the United States Court of Appeals for the Eighth Circuit in _In Re Cannon_, 741 F.2d 1139 (8th Cir. 1984). In this case, the Court ruled that the Missouri Attorney General lacked standing to challenge the dischargeability of a consumer protection restitution order already obtained by state prosecutors in state court. Thus, the State of Missouri was _completely_ foreclosed from protecting the viability of its judgment. The individual victims were, in effect, told to "go it alone" in protecting their rights. Because of the expense associated with each individual court challenge and the typically small amount of loss at stake, the consumers were denied basic protection.

The decision in _Cannon_ is also being used to prevent Attorneys General from challenging debts which are believed to be based on fraudulent practices but have not yet been made the subject of a consumer protection lawsuit. By filing for bankruptcy, the wrongdoer is effectively able to prevent restitution from even being sought by the state. Let me take a minute to tell you about one such case.

My farm division filed an adversary proceeding in bankruptcy court against two individuals and their company called Iowa Ventilation Company. After a very extensive investigation, we alleged in our "Complaint to Determine Dischargeability," that the defendant-debtors committed consumer fraud in the sale of ventilation units for use in livestock confinement facilities.

The defendant-debtors had represented significant benefits from the installation of their device. They claimed that theirs was a tested and proven ventilation system which had been subjected to numerous, rigorous tests over a period of years. In fact, we were ready to prove not only that the unit was misrepresented as to its benefits, but severe health dangers to livestock and significantly increased operating expense followed installation.

Over 180 Iowa consumers paid several thousand dollars each for this ventilation system. While the cost to each individual was not great, the sum total of the purchase price paid by these consumers was in excess of One Million Three Hundred Thousand dollars. Citing Cannon, the bankruptcy court told us that we lacked standing to bring a section 523(a)(2)(A) dischargeability complaint. The Court allowed consumers thirty days from the date of its order to file their own Section 523 complaints. Only one such consumer was able to do so. Neither consumers nor justice were served by this ruling.

Our authority to enforce state court orders for restitution in state consumer protection cases and to initiate such cases after a bankruptcy filing was annihilated by the Cannon decision. If these loopholes are not corrected, the victims which state consumer protection statutes were designed to protect will be left on their own. These victims are often the most vulnerable citizens of our states: the elderly, the low income and minorities. They cannot understand how the federal bankruptcy law can allow these things to happen to them. Neither can we.

I would now like to address the proposed language of the statute. We believe that the following language both clarifies and simplifies the Act. It additionally allows for more effective implementation of this antifraud measure. All items which we believe ought to be made nondischargeable are so identified.

> (10) To the extent that such debt arises from a violation by the debtor of a civil or criminal law enforceable by an action by a governmental unit to recover restitution, damages, civil penalties, attorney fees, costs or any other relief, or to the extent that

> such debt arises from an agreed judgment or other agreement by the debtor to pay money or transfer property in settlement of such an action by a governmental unit.

This recommendation is a result of cooperative review by the States of Connecticut, Iowa, Massachusetts and Texas.

In addition to this proposed language, we suggest an amendment to 11 U.S.C. § 1328(a) which would correspond with Senate File 2531. The reason for this suggestion is that Chapter 13 "Adjustment of Debts of an Individual With Regular Income" of the Bankruptcy Code also has a glaring loophole. Any debtor who qualifies for a Chapter 13 filing is guaranteed the discharge of a fraud judgment because the 11 U.S.C. § 1328(a) discharge provision does not except section 523(a)(2)(A) debts. The loophole can be eliminated simply with the addition of new section 523(a)(10) as an exception to discharge under a new 11 U.S.C. § 1328(a)(3).

The primary focus of my testimony today has been on the loopholes in the Bankruptcy Code from a consumer protection standpoint. This focus is a result of my service as the Chairman of the Consumer Protection Committee for the National Association of Attorneys General. Our Committee is keenly concerned about the consumer protection bankruptcy issues being discussed today. In fact, our upcoming conference is devoting one-half of its agenda to bankruptcy.

The environmental and criminal restitution aspects of Senate Bill Number 2531 are no less important to the states. Connecticut Chief State's Attorney John J. Kelly's office will argue the Robinson case next month before the United States Supreme Court. Iowa and thirty-seven other states joined as Amici Curiae with the State of Connecticut. We wish Chief State's Attorney Kelly's office well.

Over the years, State Attorneys General have worked diligently to provide a cloak of protection for consumers across the nation. Each of us has focused on matters appropriate to our office in aggressively attacking fraud in the American marketplace. We appear here today in concert to seek your assistance in removing serious loopholes from the Bankruptcy Code. Please join in helping us to protect our citizens.

Senator GRASSLEY. Mr. Kelly.

STATEMENT OF HON. JOHN J. KELLY

Mr. KELLY. Thank you.

Mr. Chairman, Senator Grassley, members of the Subcommittee on Courts, I am John J. Kelly, chief State's attorney for the State of Connecticut. My position makes me the chief prosecutorial officer in our State.

I am honored to appear before you today to support the passage of S. 2532, a bill proposed by you, Senator Grassley, that would make restitution ordered by a court as a result of a violation of State law excepted from discharge in bankruptcy. Although the act would commendably make both civil and criminal restitution orders nondischargeable, and thus would apply in consumer or environmental cases as well as larceny and assaults, I would like to focus my remarks on the criminal law aspects of the act.

One of the regrettable developments of recent times in the adminstration of criminal justice has been the erosion of the finality of criminal judgments. I am sure we can all remember a time when, in the normal course of things, a person who pleaded guilty or was found guilty by a jury would serve his sentence or pay his fine without undue delay or interruption.

Now, however, we in the criminal justice system routinely find ourselves with multiple appeals, habeas corpus petitions, and other postconviction proceedings from convicted defendants, including those who have pleaded guilty. This development has the unfortunate effect of impairing the deterrence value of criminal convictions, prolonging the anxiety of crime victims, clogging our already congested court system, and costing taxpayers thousands if not millions of dollars.

In cases in which a criminal conviction results in an order of restitution to the crime victim, we are now seeing a new method employed by criminal defendants and their lawyers to escape the consequences of their convictions. Criminal defendants are listing their court ordered restitution on bankruptcy petitions and seeking to discharge their restitution in bankruptcy court. Unfortunately, they have achieved a degree of success.

Let us take the case of *Carolyn Robinson.* In July 1980, Robinson pleaded guilty in Connecticut Superior Court to larceny in the second degree as a result of her wrongful receipt of $9,932.95 in welfare benefits while simultaneously receiving Social Security payments. In Connecticut in 1980, larceny in the second degree was a class D felony, the maximum penalty for which was imprisonment for 5 years and fine of $5,000. The State judge sentenced Robinson to a suspended prison term of 1 to 3 years, placed her on probation for 5 years, and ordered her to make restitution to the State in monthly payments of the full amount she stole.

Between November 1980 and May 1981, Robinson paid back $450. Meanwhile, Robinson had filed for bankruptcy and listed her restitution order on her schedule of dischargeable debts. In May 1981, Robinson stopped making her monthly restitution payments.

State agencies were a bit confused about how to handle the situation and did not file a timely objection to discharge or take any other immediate action. In 1984, however, the State probation department requested that Robinson resume payments. Robinson then brought suit in U.S. bankruptcy court seeking a determination that her restitution obligation was discharged.

The bankruptcy and district courts agreed that criminal restitution is not a dischargeable debt, but the U.S. Court of Appeals for the Second Circuit reversed. In a concurring opinion, however, Judge Mansfield urged Congress to remedy the "unfortunate loophole" in the Bankruptcy Code because otherwise the effect of the court's decision in many instances would be to "stultify and render useless criminal restitution payments as a means of punishing persons convicted of felonies." The Supreme Court granted our petition for certiorari and will hear arguments in *Kelly* v. *Robinson* on October 8.

I do have some copies of the State's brief filed in that matter. If it would help this committee, I can leave them with you.

Carolyn Robinson is not alone in her attempt to avoid paying her court ordered restitution by filing for bankruptcy. Some seventeen other individuals in Connecticut have attempted to do so. Most of these persons owe restitution to the State as a result of welfare fraud, but some must pay restitution because of their embezzlement from or injury to private citizens. Presently at stake is some $30,000.

It is true that in many of these cases, particularly those involving larcenies, the State could object to, and in fact has objected to, the discharge of restitution based on the existing exceptions to discharge in section 523(a) of title 11. But there are a number of reasons why this approach is undesirable. First, when a State court has already adjudicated an individual guilty of a crime beyond reasonable doubt, State prosecutors should not then have to shoulder the added burden of learning the intricacies of bankruptcy law, and believe me that is a burden, filing a complaint in Federal court, paying filing fees, participating in discovery, engaging in motion practice, and, in some cases, proving their case over again, simply to ensure that a convicted criminal does not escape the punishment that the criminal court imposed. Nor should this burden be simply passed on to crime victims. Victims have already suffered enough as a result of someone else's crime and they should not have to go to the added expense of hiring a lawyer to obtain the restitution that a State court has already ordered. In short, neither State prosecutors nor crime victims should have to become supplicants in bankruptcy court to enforce criminal judgments.

In many cases, moreover, prosecutors and crime victims have no option at all. Although the existing exceptions to discharge seem broad, the fact of the matter is that no exception exists that would prevent the discharge of restitution in cases involving common State crimes such as reckless manslaughter, criminally negligent homicide, reckless assault with a deadly weapon, negligent assault with a deadly weapon, reckless burning, bribery, receiving kickbacks, cruelty to animals, or professional gambling. In these cases a true loophole—indeed, a gaping hole—currently exists.

This hole must be plugged. Restitution is an essential component of a State court's sentencing options. Restitution serves traditional purposes of punishment because the obligation to restore a crime victim's property vindicates society's interest in peaceful retribution. And while the focus of any restitution is on the offender, rather than the victim, we cannot ignore the fact that recompense to the crime victim is a laudable consequence of restitution.

I am aware of that some opponents of this act may argue that it conflicts with the Bankruptcy Code's goal of affording a "fresh start" for debtors. The fresh start policy, however, was intended to relieve honest debtors of the burden of financial overextension, not to relieve criminals of the consequences of their crimes. In fact, to the extent that the code allows for the discharge of criminal restitution, it may actually defeat the fresh start policy. Sentencing judges faced with the prospect of seeing restitution orders discharged in bankruptcy may well impose jail terms instead. Certainly a debtor who is in jail will not have a full opportunity to obtain the "fresh start" that the Congress intended to provide.

Senator Grassley, in the existing Bankruptcy Code Congress has provided for the exception from discharge of certain taxes, fraudulently created debts, alimony and child support payments, debts arising from willful injury, tax fines and penalties, student loans, and debts incurred as a result of drunk driving. It is hard to see why criminal restitution should not be included in this list. Indeed, because of the important role that restitution plays in our criminal justice system, I think it fair to say that restitution should be at the top of the list. Surely none of us here wants to see the growth of a revolving door system of justice whereby a defendant convicted of a crime in State criminal court can merely walk across the street to Federal bankruptcy court and escape justice. S. 3531 will go a long way in preventing that result from happening and will close a loophole in bankruptcy law which allows a convicted felon to avoid making court ordered restitution.

Mr. Chairman, Senator Grassley, thank you very much for allowing me to appear here before you and testify. I would be happy to answer any questions you might have.

Senator GRASSLEY. Before we do that we will go to Mr. Siemens. But we will also include, if you will leave those, those briefs. We will include those in the record.

[Submission for the record follows:]

No. 85-1033

In The
Supreme Court Of The United States

OCTOBER TERM, 1985

JOHN J. KELLY,
CONNECTICUT CHIEF STATE'S ATTORNEY, ET AL.,
Petitioners,

v.

CAROLYN ROBINSON,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF OF THE PETITIONERS

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QUESTION PRESENTED

IS A CRIMINAL RESTITUTION ORDER DISCHARGEABLE AS A DEBT IN BANKRUPTCY?

LIST OF ALL PARTIES

In addition to petitioner John J. Kelly, Connecticut Chief State's Attorney, the other petitioners are: Director, Officer of Adult Probation; Commissioner, Department of Income Maintenance; and Commissioner, Department of Administrative Services. The sole respondent is Carolyn Robinson.

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No. 85-1033

In The
Supreme Court Of The United States

OCTOBER TERM, 1985

JOHN J. KELLY, CONNECTICUT
CHIEF STATE'S ATTORNEY, ET AL.,
Petitioners,

v.

CAROLYN ROBINSON,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF OF THE PETITIONERS

OPINIONS BELOW

The opinion of the United States Bankruptcy Court for the District of Connecticut, which was adopted by the United States District Court for the District of Connecticut, is reported at 45 B.R. 423 (Bankr. D. Conn. 1984), and is reprinted in Appendix A to the Petition, pages 1A–6A. The bankruptcy and district courts relied heavily on the opinion in

In re Pellegrino, which is reported at 42 B.R. 129 (Bankr. D. Conn. 1984), and is reprinted in Appendix B to the Petition, pages 7A–27A. The opinion of the United States Court of Appeals for the Second Circuit is reported at 776 F.2d 30 (2d Cir. 1985), and is reprinted in Appendix C to the Petition, pages 28A–54A. This Court's grant of certiorari is reported at 106 S.Ct. 1181 (1986).

JURISDICTION

The United States Court of Appeals for the Second Circuit rendered its decision on October 29, 1985. No petitions for rehearing or requests for an extension of time within which to file a petition for certiorari were filed. The petition for certiorari was filed on December 13, 1985 and granted by this Court on February 24, 1986. This Court has jurisdiction to review by writ of certiorari the judgment of the United States Court of Appeals for the Second Circuit pursuant to 28 U.S.C. § 1254(1).

STATUTES INVOLVED

This case primarily involves the following statutes: 11 U.S.C. § 101(4), (11), concerning the definition of "claim" and "debt," 11 U.S.C. § 105, concerning the injunctive powers of the bankruptcy court, 11 U.S.C. § 362, concerning the automatic stay, 11 U.S.C. § 523, concerning exceptions to discharge, and 11 U.S.C. § 727(b), concerning the effect of discharge. These statutes are set out verbatim at pages v–xxi of the Petition. (Pet.) The petitioners also will refer to 11 U.S.C. § 524(a), concerning the effect of discharge, 11 U.S.C. § 525, concerning the prohibition of discrimination against bankrupts, 11 U.S.C. § 35a (repealed 1979) of the 1898 Bankruptcy Act, concerning the nondischargeability of certain civil obligations, 11 U.S.C. § 93j (repealed 1979), concerning proof and allowance of claims, 11 U.S.C. § 103a (repealed 1979), concerning provability of debts, and Conn. Gen. Stat.

§§ 53a-30–33, concerning the probation system in Connecticut. These statutes are set out in the Appendix to this Brief (App. to Br.). Other statutes of lesser import are cited in the argument. Citations are to the most recent version of the statute unless otherwise noted.

STATEMENT OF THE CASE

This case raises the question of whether a federal bankruptcy court has any authority to nullify a valid final judgment of a state criminal court and thus allow a convicted criminal, sentenced to make restitution, to escape justice by the simple expedient of listing the restitution order as a dischargeable debt on her bankruptcy petition.

The facts are not in dispute.[1] On July 28, 1980, the respondent, Carolyn Robinson, pleaded guilty in Connecticut Superior Court to the crime of larceny in the second degree. *See* Conn. Gen. Stat. § 53a-123 (1979). The conviction arose out of Robinson's wrongful receipt of $9,932.95 in public assistance benefits from the petitioner Connecticut Department of Income Maintenance (CDIM) while simultaneously receiving Social Security benefits. On November 14, 1980, a state superior court judge sentenced Robinson to a prison term of not less than one year nor more than three years, execution of which was suspended, and to probation for five years on the condition that she make restitution to the State of Connecticut in the amount of $9,932.95 at the rate of $100.00 per month, commencing January 16, 1981. A payment at that rate commencing at that time meant that the total amount that Robinson would have to restore over the five year probationary period amounted to $5,800.00.

On February 5, 1981, Robinson filed a voluntary petition for bankruptcy under Chapter 7 in the United States Bankruptcy Court for the District of Connecticut. *See* 11 U.S.C. § 701 et seq. The petition contained a schedule of creditors that listed, among others, CDIM as having a claim of $6,000 for public assistance and the petitioner Connecticut

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[1] Except where otherwise noted, the following statement of facts derives from the statement of facts contained in the Second Circuit and bankruptcy court opinions. *See* Appendix to Petition (App. to Pet.) at 3A–4A, 30A–33A.

Office of Adult Probation (COAP) as having a claim of $9,932.95 for restitution. On February 20, 1981, the bankruptcy court notified both CDIM and COAP of Robinson's Chapter 7 petition, but neither agency filed any form of objection to discharge by the April 27, 1981 deadline for doing so. On May 14, 1981, the bankruptcy court issued an order discharging Robinson from all dischargeable debts, declaring null and void all existing or future judgments that purported to hold Robinson personally liable with respect to any such dischargeable debts, and enjoining all creditors whose debts were thereby discharged from thereafter endeavoring to collect such debts.

Up until May 4, 1981, Robinson had made restitution payments totaling $450. After receiving her bankruptcy discharge on May 14, 1981, Robinson notified COAP of her intent to discontinue making payments and did in fact cease making them.

The petitioner state agencies took no action until February, 1984, when COAP wrote Robinson a letter requesting that she resume payment. At about the same time Robinson filed an adversary proceeding in United States Bankruptcy Court for the District of Connecticut, naming as defendants the Commissioner of CDIM, the Commissioner of the Connecticut Department of Administrative Services, the Director of COAP, and the Connecticut Chief State's Attorney. Robinson sought a declaration that the May 14, 1981 discharge order had discharged her restitution obligations to COAP and CDIM, an injunction prohibiting the named state officials from taking any steps to obtain further restitution payments, a finding that the state officials were in contempt of court, and an award of attorney's fees under 42 U.S.C. § 1988.

On March 19, 1984, COAP wrote Robinson a second letter requesting a $100 payment by April 1, 1984. J.A. at 23A. Approximately one week later Robinson filed a motion in a bankruptcy court for a preliminary injunction against state restitution enforcement efforts. J.A. at 41A. On April 2, 1984, Robinson nevertheless made an additional $100 payment, bringing her total restitution payments to $550. J.A. at 44A. On the next day, the bankruptcy court denied the motion for a preliminary injunction. J.A. at 42A. The state, on April 16, 1984, thereupon served Robinson with a Notice to Appear for Violation of Probation premised on her failure to pay the accumulated arrearage. J.A. at 43A. With the agreement of the state, Robinson then obtained in state superior court a stay of the probation violation proceedings pending final disposition of the federal lawsuit. J.A. at 46A.

Following a brief trial on the merits later in 1984, the bankruptcy court entered a Memorandum and Proposed Order denying all relief that Robinson sought. Relying on its decision in the companion case of *In re Pellegrino*, 42 B.R. 129 (Bankr. D. Conn. 1984), the bankruptcy court concluded that a criminal restitution order does not constitute a bankruptcy "debt" within the meaning of 11 U.S.C. § 101(11) and that, even if it does, such a debt is a "penalty" and thus exempt from discharge under 11 U.S.C. § 523(a)(7). The district court adopted the proposed order and judgment entered for the state officials.

Upon appeal by Robinson, the United States Court of Appeals for the Second Circuit reversed. The court's opinion observed that a majority of the courts considering the issue have held that a criminal restitution obligation is not a debt under the Bankruptcy Code and that only one decision, *In re Brown*, 39 B.R. 820 (Bankr. M.D. Tenn. 1984), had held to the contrary. App. to Pet. at 35A–36A, 38A. In adopting what was thus a minority rule, the Second Circuit relied on the fact that Congress had intended a broad meaning for the word "debt," that the Code defined debt as a "right to payment," and that restitution created a right to payment since COAP had a right to receive and enforce payment of the restitution obligation. App. to Pet. at 34A–43A, 45A–47A. The court explained that the Code's legislative history revealing Congress to have stated that "[t]he bankruptcy laws are not a haven for criminal offenders, but are designed to give relief from financial over-extension," referred primarily to the exemption of criminal actions from the automatic stay, *see* 11 U.S.C. § 362(b)(1), not to the definition of "debt." App. to Pet. at 43A–45A. The court added that the existence of the automatic stay exemption and of a specific exemption from discharge for fines and penalties, *see* 11 U.S.C. § 523(a)(7), demonstrated that "Congress drew such lines as it thought appropriate to grant or deny criminals the benefits of the bankruptcy laws," and that the majority line of cases had simply "impermissibly reordered the priorities established by Congress." App. to Pet. at 44A–45A. The court sought to distinguish four federal court of appeals cases that held or suggested that restitution is nondischargeable on the ground that in those cases the restitution obligation arose or would have arisen after bankruptcy and thus could not have constituted a "debt" under 11 U.S.C. § 727(b). App. to Pet. at 41A–43A. Finally, the court determined that the exemption from discharge in 11 U.S.C. § 523(a)(7) for a "penalty . . . payable to and for the benefit of a governmental unit . . . [that] is not compensation for actual pecuniary loss" did not apply. Ap. to Pet. at 37A–42A. The court reasoned that the phrase "not compensation for actual pecuniary loss" referred to obligations that where wholly non-compensatory and excluded those that were partly compensatory. App. to Pet. at 41A. Thus the court could find that even though restitution represented a "penalty . . . payable to and for the benefit of a governmental unit," it did not fit within the § 523(a)(7) exemption from discharge because it was at least partly compensatory in nature. App. to Pet. at 41A–42A.

Judge Mansfield concurred in a separate opinion. App. at 53A–54A. He wrote that the court had reached an accurate but "unfortunate result." According to Judge Mansfield, the effect of the court's decision in many instances would be to "stultify and render useless criminal restitution payments as a means of punishing persons convicted of felonies." Judge Mansfield expressed his fear that "[t]he convicted criminal will simply use bankruptcy to escape the obligation to make criminal restitution payments ordered by the court." In closing, Judge Mansfield urged Congress to remedy 'this unfortunate loophole" by amending 11 U.S.C. § 523(a)(7) to make criminal restitution payments non-dischargeable in bankruptcy.

Apparently because of the importance of the question presented[2] and the apparent conflict among the circuits,[3] this Court granted certiorari.

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[2] This case represents a sequel to *Ohio v. Kovacs,* 105 S. Ct. 705 (1985), which held that the monetary costs of a state-obtained injunction requiring a debtor to clean up a hazardous waste site constituted a debt in bankruptcy. The resolution of the issue in this case will have a significant impact on the ability of federal and state governments to fashion punishment that meets the crime. *See* Brief of Amicus Curiae States; Brief of National Governors' Association, et al., as amici curiae in Support of Petitioners.

[3] The Fifth, Seventh, and Ninth Circuits have held that a prior bankruptcy discharge of a debt created by the debtor's criminal fraud does not prevent a federal criminal court from later ordering the defendant to make restitution to the fraud victim in the amount of the loss. *United States v. Carson,* 669 F.2d 216, 217 (5th Cir. 1982); *United States v. Alexander,* 743 F.2d 472, 474, 480 (7th Cir. 1984); *United States v. Roberts,* 783 F.2d 767 (9th Cir. 1985). The Third, Fifth and Eleventh Circuits have all held that absent extraordinary circumstances a federal court should not enjoin a state criminal proceeding that might result in a restitution order requiring the defendant to pay back a discharged debt, *In re Davis,* 691 F.2d 176 (3d Cir. 1982), or a debt that may be discharged at the conclusion of pending bankruptcy proceedings. *McDonald v. Burrows,* 731 F.2d 294, 297-99 (5th Cir.), *cert. denied,* 105 S. Ct. 173 (1984); *Barnette v. Evans,* 673 F.2d 1250 (11th Cir. 1982). The Second Circuit attempted to distinguish these decisions on the ground that the restitution orders there represented nondischargeable post-petition debts under 11 U.S.C. § 727(b); Pet. at xviii, whereas in the present case the restitution obligation arose well before bankruptcy. These other Courts of Appeals, however, did not limit their decisions to post-petition restitution and instead suggested that Congress never intended to permit the discharge of any criminal restitution, whenever imposed. *See, e.g. United States v. Alexander,* 743 F.2d at 480 ("The bankruptcy proceeding is largely unconcerned with criminality"); *Barnette v. Evans,* 673 F.2d at 1251 ("The purpose of bankruptcy is to protect those in financial, not moral, difficulty").

SUMMARY OF ARGUMENT

I.A. Criminal restitution is not a debt within the meaning of the Bankruptcy Code. The Code defines "debt" as a liability on a claim and a "claim" as a right to payment. Criminal restitution does not confer a right to payment on the crime victim, who has no right to enforce the restitution order. Nor does it give a right to payment to the court or probation system, since they have no right to retain or assign the restitution payments. Criminal restitution is part of the punishment for a crime, not a mere monetary obligation to a creditor.

B. By the time of the passage of the Code in 1978, the courts had carved from the concept of bankruptcy debts an exception for criminal sanctions. Since Congress in 1978 did not specifically alter this exception, this Court must presume that it sought to maintain it. Indeed, the only salient expression of Congress in the legislative history of the Code was its statement that "the bankruptcy laws are not a haven for criminal offenders, but are designed to give relief from financial over-extension."

C. The opposite conclusion, that criminal restitution is a bankruptcy debt, would contravene fundamental notions of public policy. It would mean that a federal court could nullify enforcement of a valid final judgment of a state court in violation of the principles of federalism articulated in *Younger v. Harris,* 401 U.S. 37 (1971). And it would create the absurd result that a person could commit a criminal act that benefits the criminal or damages others financially and at the same time leaves the state without any viable means to make the criminal pay back his gain or repair the damage.

II. Alternatively, even assuming criminal restitution is a debt, it is excepted from discharge by 11 U.S.C. § 523(a)(7). This provision makes nondischargeable "a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit [that is] not compensation for actual pecuniary loss." The Court of Appeals agreed that restitution is a "penalty . . .

payable to and for the benefit of a governmental unit." And although restitution has compensatory consequences, it in essence is "not compensation for actual pecuniary loss." This point is especially true when one construes this phrase in light of the policy underlying the Code against the creation of a means whereby a criminal can escape punishment.

ARGUMENT

A CRIMINAL RESTITUTION ORDER IS NOT DISCHARGEABLE AS A DEBT IN BANKRUPTCY

I. A CRIMINAL RESTITUTION ORDER IS NOT A "DEBT"

The concept of criminal restitution has a history "older than the English legal tradition as a whole." *United States v. Florence*, 741 F.2d 1066, 1067 (8th Cir. 1984). As a condition of probation in Connecticut and elsewhere, *see* Conn. Gen. Stat. § 53a-30(a)(4); 18 U.S.C. § 3651, 43 Stat. 1259-60 (1925); 18 U.S.C.A. § 3563(b)(3) (1985), restitution constitutes "an authorized mode of mild and ambulatory punishment . . . intended as a reforming discipline." *Korematsu v. United States*, 319 U.S. 432, 435 (1943). Restitution, moreover, "undoubtedly serves traditional purposes of punishment" because the obligation to restore a crime victim's property "vindicat[es] society's interest in peaceful retribution." *United States v. Brown*, 744 F.2d 905, 909 (2d Cir.), *cert. denied*, 105 S. Ct. 599 (1984). "While recompense to the victim is a laudable consequence of restitution, the focus of any probation regime is on the offender." *United States v. Carson*, 669 F.2d at 217. *Accord* Note, *Victim Restitution in the Criminal Process: A Procedural Analysis*, 97 Harv. L. Rev. 932, 937 (1984); Brief of Amicus Curiae States, part I.

A. Statutory Considerations

The principal question in this case is whether restitution constitutes a "debt" within the meaning of the Bankruptcy Code. This question arises because § 727(b) of the Code discharges a qualified debtor "from all *debts*," subject to the exceptions to discharge enumerated in 11 U.S.C. § 523 and discussed later in this brief. 11 U.S.C. § 727(b); Pet. at xviii (emphasis added). Section 524(a)(1), moreover, voids any judgment that represents a determination of the personal liability of the debtor "with respect to a *debt* discharged under section 727." 11 U.S.C. § 524(a)(1); App. to Br. at 1A (emphasis added). Finally, § 524(a)(2) operates as an injunction against the commencement or continuation of an action "to collect, recover or offset any such *debt* as a personal liability of the debtor." 11 U.S.C. § 524(a)(2) (emphasis added); App. to Br. at 1A.

When, as here, the resolution of a federal question turns on the meaning of a statute and the intention of Congress, this Court looks first to the statutory language and then to the legislative history if the statutory language is unclear. *Blum v. Stenson*, 465 U.S. 886, 896–97 (1984). The task of a federal court is "to interpret the words of . . . statutes in light of the purposes Congress sought to serve." *Chapman v. Houston Welfare Rights Organization*, 441 U.S. 600, 608 (1979). "[I]nterpretations of a statute which would produce absurd results are to be avoided if alternate interpretations consistent with the legislative purpose are available." *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 575 (1982).

The Bankruptcy Code defines "debt" as a "liability on a claim," 11 U.S.C. § 101(11), and a "claim," in pertinent part, as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal equitable, secured, or unsecured." 11 U.S.C. § 101(4)(A); Pet. at v. Criminal restitution does not qualify as a "debt" or "claim" since neither the crime victim nor the state court system has such a "right to payment."[4]

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[4] The Code also defines a "claim" as a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment." 11 U.S.C. § 101(4)(B); Pet. at v–vi. As discussed later, it was under this definition that this Court found a claim and debt to exist in *Ohio v. Kovacs*, 105 S. Ct. at 708. The respondent in this case has never asserted that restitution gives rise to this sort of claim and the court below did not address the matter.

1. The Court of Appeals essentially agreed that a crime victim has no "right to payment" of restitution, referring to the prevailing view of the bankruptcy courts to that effect and discussing only whether COAP has such a right. App. to Pet. at 36A–37A, 46A–48A. *See also In re Pellegrino*, 42 B.R. 129, 132–33 (Bankr. D. Conn. 1984); App. to Pet. at 13A–14A. This view is unquestionably correct. In Connecticut, as elsewhere, a crime victim has no right to determine the restitutionary amount, no absolute right even to testify at a restitution hearing, no right to appeal a restitution determination he deems inadequate, and no right to enforce payment. *See In re Pellegrino*, 42 B.R. at 132; App. to Pet. at 12a; Conn. Gen. Stat. § 53a-30(a)(4) (providing that "the amount [of restitution] and the manner of performance" shall be fixed by "the court"); App. to Br. at 6A. *Accord United States v. Brown*, 744 F.2d at 910 (applying federal law); *In re Johnson*, 32 B.R. 614, 616 (Bankr. D. Colo. 1982) (applying Colorado law). A crime victim is a beneficiary of restitution, but he has no legal right to obtain it.

2. Nor does the state court or probation system in imposing or collecting restitution hold a "claim" or "right to payment." Under Connecticut law, a sentencing court may suspend a prison sentence, impose probation, and order as a condition of probation the payment of restitution "in an amount [the defendant] can afford to pay or provide in a suitable manner, for the loss or damage caused thereby." Conn. Gen. Stat. §§ 53a-29, 53a-30(a)(4); App. to Br. at 6A. Criminal defendants ordered to make restitution send their payments to COAP, which is an agency within the judicial department, Conn. Gen. Stat. § 54-103a, and COAP, in turn, sends these payments to the crime victim. App. to Pet. at 12A, 51A. COAP officers monitor compliance with the restitutionary order and may apply to the sentencing court for an arrest warrant or notice to appear, or may make a warrantless arrest, in the event of a suspected violation of probation. Conn. Gen. Stat. § 53a-32(a); App. to Br. at 7A. If after a hearing the state establishes a violation of probation, the court may modify or

enlarge the conditions of probation or it may revoke probation and order the defendant incarcerated for any length of time up to the term of the suspended sentence. Conn. Gen. Stat. § 53a-32(b); App. to Br. at 8A.

These facts alone, wholly apart from the other factors discussed below, make it apparent that the conclusion of the Court of Appeals that COAP has a "claim" and "right to payment" strains these terms too far. The same is true if one expands the inquiry to include the sentencing court. While the sentencing court can set the amount of restitution and ultimately modify or revoke probation for nonpayment, and COAP can receive payments in the first instance, neither the court nor COAP can retain these payments. Neither can assign the obligation. And neither judicial agency stands in the shoes of the ordinary creditor. As explained, the purpose of restitution is not to compensate the victim, and certainly not to compensate the court system, but rather to impose a form of punishment on the offender. *United States v. Carson, supra;* Note, *Victim Restitution in the Criminal Process: A Procedural Analysis, supra.* The immediate genesis of a restitution obligation is not the creation of monetary indebtedness but rather the adjudication of criminal guilt beyond a reasonable doubt. *United States v. Brown,* 744 F.2d at 909. When the government orders restitution it acts not as a creditor but in the "separate realm of the administration of the criminal laws." *134 Baker Street, Inc. v. Georgia,* 47 B.R. 379, 381 n.1 (N.D. Ga. 1984).

This conclusion does not differ when, as here, the victim is a governmental agency and thus when the state, in a collective sense, retains the restitutionary payments. For purposes of determining the bankruptcy status of restitution this Court must consider the victim governmental agency as a separate entity from the state court system, as has the bankruptcy court in Connecticut. *In re Pellegrino,* 42 B.R. at 134; App. to Pet. at 16A. Any other approach would prove anomalous. It would mean that restitution might not qualify as a dischargeable debt when the debtor steals from a a private victim, because the state has no right to retain the payments, but that restitution might become a dischargeable debt when a person steals from the state and must make restitution payments retained by an arm of the government. In terms of their ability to enforce restitution, the victims of a crime against the government—ultimately the people—cannot have fewer rights than does a private victim. While the state is not a true "creditor" in any restitution case, the resolution of the issue certainly cannot turn on whether a state agency other than the court system retains the restitution payments.

3. The position that criminal restitution is not a "debt" that creates a "right to payment" squares fully with and in fact derives support from this Court's recent decision in *Ohio v. Kovacs*, 105 S. Ct. 705 (1985). *Kovacs* held that the monetary costs of a state-obtained injunction requiring a debtor to clean up a hazardous waste site represented a bankruptcy debt. Although the issue in *Kovacs* was whether Ohio had a claim within § 101(4)(B), which refers to a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment," and not, as here, whether the state had a simple "right to payment" under § 101(4)(A), a "right to payment" is literally a component of a § 101(4)(B) claim and this Court specifically held that the debtor's obligation to Ohio gave rise to such a right. 105 S. Ct. at 708-11; Pet. at v-vi. Nevertheless, the difference between *Kovacs* and the appeal at bar is clear. It is no less than the difference between a civil case and a criminal case. This Court has frequently emphasized "society's compelling interest in finding, convicting, and punishing those who violate the law," *Moran v. Burbine*, 106 S. Ct. 1135, 1144 (1986), and the " 'legitimate and compelling state interest' in protecting the community from crime." *Schall v. Martin*, 104 S. Ct. 2403, 2410 (1984). In a variety of contexts this Court or Members thereof have adverted to the primacy of the criminal law. *See Younger v. Harris*, 401 U.S. 37, 55 n.2 (Stewart, J., concurring) ("A state's decision to classify conduct as criminal provides some

indication of the importance it has ascribed to prompt and unencumbered enforcement of the law"); *In re Johnson*, 167 U.S. 120, 126 (1897) ("The law will not permit a person to be kidnapped or decoyed within the jurisdiction for the purpose of being compelled to answer to a mere private claim, but in criminal cases the interests of the public override that which is, after all, a mere privilege from arrest"). Indeed, the *Kovacs* Court attempted to make clear that its holding did not extend to criminal cases:

> It is well to emphasize what we have not decided. First, we do not suggest that Kovacs' discharge will shield him from prosecution for having violated the environmental laws of Ohio or for criminal contempt for not performing his obligations under the injunction prior to bankruptcy. Second, had a fine or monetary penalty for violation of state law been imposed on Kovacs prior to bankruptcy, § 523(a)(7) forecloses any suggestion that his obligation to pay the fine or penalty would be discharged in bankruptcy.

105 S. Ct. at 711. Although this language extends literally only to fines and penalties and implicitly treats them as nondischargeable debts under § 523(a)(7) rather than as nondebts under § 101(11), it nonetheless plainly indicates this Court's view of the Bankruptcy Code as having minimal application to criminal judgments. *Kovacs* thus provides considerable support for the conclusion that criminal restitution is not a bankruptcy debt. *See also* Brief of National Governors' Association, et al., as amici curiae in Support of Petitioners, part II.A.

4. The respondent will no doubt point to the language of § 523(a)(7) providing for an exception to discharge "to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit" and argue that the Code refers to fines and penalties, and thus implicitly restitution, as "debts." This argument is resourceful but

ultimately unpersuasive. In the first place it appears from an examination of the remainder of § 523(a)(7), *see* Petition at xv, and the pertinent discussion of the Senate Judiciary Committee Report on the then-proposed Bankruptcy Code, both of which discuss only tax-related matters, that Congress in enacting § 523(a)(7) intended to address the status of civil tax penalties, not criminal sanctions.[5] Second, the exception stated in subsection (a)(7), like only two other exceptions to discharge among the nine enumerated in § 523(a), uses the language "to the extent such debt is for . . . ." *See also* 11 U.S.C. §§ 523(a)(5)(A), 523(a)(9); Pet. at xiv, xvi. It thus leaves entirely open whether a penalty such as criminal restitution is to any extent a debt.

In this respect subsection (a)(7) resembles its predecessor, § 57j of the 1898 Bankruptcy Act. 11 U.S.C. § 93j (repealed 1979); App. to Br. at 4A. *See In re Cox*, 33 B.R. 657, 658 (Bankr. M.D. Ga. 1983). Section 57j provided that:

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[5] The Senate Report provides:

> Paragraph (7) makes nondischargeable certain liabilities for penalties including tax penalties if the underlying tax with respect to which the penalty was imposed is also nondischargeable (sec. 523(a)(7)). These latter liabilities cover those which, [sic] but are penal in nature, as distinct from so-called "pecuniary loss" penalties which, in the case of taxes, involve basically the collection of a tax under the label of a "penalty." This provision differs from the bill as introduced, which did not link the nondischarge of a tax penalty with the treatment of the underlying tax. The amended provision reflects the existing position of the Internal Revenue Code [Title 26] (Rev. Rul. 68-574, 1968-2 C.B. 595).

S. Rep. No. 989, 95th Cong. 2d Sess. 79 (1978), *reprinted in* 1978 U.S. Code Cong. & Ad. News 5865. Although the paragraph seems to be missing a line, the Report clearly reveals the Senate Judiciary Committee's intention that § 523(a)(7) address the dischargeability of civil tax penalties such as those authorized in 26 U.S.C. § 6651 et seq. Thus construed, § 523(a)(7) focuses on an issue that had generated much litigation and uncertainty under the 1898 Bankruptcy Act. *See* 3 *Collier on Bankruptcy* ¶ 57.22[2], [2.1] (14th ed. 1977).

> Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss according to law.

Although the language of § 57j suggests that penalties owing to the United States or to any State were "debts," many courts interpreting the 1898 Act had held or stated that criminal fines and penalties were in fact not debts. *See Zwick v. Freeman*, 373 F.2d 110, 116 (2d Cir.), *cert. denied*, 389 U.S. 835 (1967); *Parker v. United States*, 153 F.2d 66, 71 (1st Cir. 1946); *In re Abramson*, 210 F. 878, 880 (2d Cir. 1914); *In re Moore*, 111 F. 145, 149-50 (W.D. Ky. 1901); *People v. Washburn*, 97 Cal. App. 3d 621, 158 Cal. Rptr. 822, 824-25 (1979); *People v. Mosesson*, 78 Misc. 2d 217, 356 N.Y.S.2d 483, 484-85 (Sup. Ct. 1974). Thus both § 57j and § 523(a)(7) concern those fines or penalties that qualify as "debts," but neither has purported to determine what fines or penalties fit within that category. As this Court has stated, "a section of statute should not be read in isolation from the context of the whole Act and . . . in interpreting legislation [this Court] 'must not be guided by a single sentence or member of a sentence but [should] look to the provisions of the whole law, and to its object and policy.' " *Richards v. United States*, 369 U.S. 1, 11 (1962) (quoting *United States v. Boisdoré's Heirs*, 49 U.S. (8 How.) 113, 122 (1850)). Congress defined "debt" in § 101(11). Section 523(a)(7) is not a provision defining "debt" but rather one creating an exception to discharge. Any argument that § 523(a)(7) reveals the intent of Congress to resolve the question of whether criminal restitution is a bankruptcy debt is one that wrenches § 523 out of context and overlooks other considerations found in the Code and its purposes. *Richards v. United States, supra.*

5. It is true, as the Court of Appeals emphasized, that Congress intended to create the broadest possible definition of the terms "debt" and "claim." App. to Pet. at 37A–39A, 42A. But this Court "interpret[s] the words of . . . statutes in light of the purposes Congress sought to serve." *Chapman v. Houston Welfare Rights Organization, supra.* This Court long ago stated that the purpose of the bankruptcy laws is to "convert the assets of the bankrupt into cash for distribution among creditors, and then to relieve the *honest* debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon *business misfortunes.*" *Williams v. United States Fidelity & Guaranty Co.*, 236 U.S. 549, 554–55 (1915) (emphasis added). "The various provisions of the Bankruptcy Act were adopted in the light of that view and are to be construed when reasonably possible in harmony with it so as to effectuate the general purpose and policy of the act." *Local Loan Co. v. Hunt,* 292 U.S. 234, 245 (1934). It is thus fully appropriate to interpret the term "debt" as broadly as possible to relieve the honest debtor from his misfortunes. At the same time it would be highly inappropriate and destructive of Congressional purposes to construe the term "debt" to allow a criminal to escape punishment.

B. Historical Considerations

The normal rule of statutory construction is that "if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific." *Midlantic National Bank v. New Jersey Department of Environmental Protection,* 106 S. Ct. 755, 759–60 (1986). By the time of the passage of the Bankruptcy Code in 1978, the courts had made clear that criminal sanctions with monetary consequences did not represent bankruptcy debts. The absence of any evidence that Congress in 1978 intended to change this prevailing view thus indicates that Congress in fact had no intent to change it.

1. As early as 1846 this Court, in *Spalding v. New York ex rel. Backus,* 45 U.S. (4 How.) 21 (1846), summarily affirmed a decision of a New York state court that had held that a fine for criminal contempt was not a debt within the bankruptcy law. Other courts, with near unanimity, later followed suit. A federal district court ruled in 1901 that a fine for a substantive criminal offense did not constitute a debt, reasoning that "[t]he provisions of the bankrupt act have reference alone to civil liabilities, as demands between debtor and creditors, as such, and not to punishment inflicted pro bono publico for crimes committed." *In re Moore,* 111 F. 145, 150 (W.D. Ky. 1901). *Contra In re Alderson,* 98 F. 588 (D. W. Va. 1899). *See also* 11 U.S.C. § 1(14), 30 Stat. 544 (1898) (repealed 1979) (defining "debt" under the 1898 Act as "any debt, demand, or claim provable in bankruptcy.") In a 1914 case holding that a civil penalty for violation of a state agriculture law did not create a provable bankruptcy debt the Second Circuit observed that "bankrupts who have violated laws passed for the public good cannot escape punishment by going into bankruptcy." *In re Abramson,* 210 F. 878, 880 (2d Cir. 1914). Citing *Spalding,* the First Circuit noted in 1946 that, while a fine for civil contempt might qualify as a debt, a fine for criminal contempt would not: "It was not in the contemplation of Congress that the federal bankruptcy power should be employed to pardon a bankrupt from the consequences of a criminal offense, whether the criminal contempt be against the authority of a state or federal court." *Parker v. United States,* 153 F.2d 66, 71, 72-73 (1st Cir. 1946). And as recently as 1967 in a case in which a debtor claimed that nonmonetary agricultural sanctions imposed by the federal government violated the Bankruptcy Act the Second Circuit remarked that "governmental sanctions are not regarded as debts even when they require monetary payments" and cited the First Circuit and district court precedents to that effect. *Zwick v. Freeman,* 373 F.2d 110, 116 (2d. Cir.), *cert. denied,* 389 U.S. 835 (1967). This body of case law prompted the following conclusion in the 1975 edition of Collier on Bankruptcy: "It is almost generally accepted that the liability for a fine or penalty is not dischargeable, if for no other reason than the imperative

necessity of enforcing criminal sanctions enacted for the public welfare." 3A Collier on Bankruptcy ¶ 63.12 (14th ed. 1975). (footnote omitted).[6]

Restitution cases decided under the Bankruptcy Act of 1898 proved no exception to this trend. A New York state court, relying on the principle that "[a] bankruptcy proceeding is civil in nature and is intended to relieve an honest and unfortunate debtor of debts and to permit him to begin his financial life anew," concluded that "[a] discharge has no effect whatsoever upon a condition of restitution in a criminal sentence." *People v. Mosesson*, 78 Misc. 2d 217, 356 N.Y.S.2d 483, 484-85 (Sup. Ct. 1974). A second New York court cited this language favorably in a case in which the debtor sought an injunction against a pending criminal prosecution. *People ex rel. Auerbach v. Topping Bros.*, 79 Misc. 2d 260, 359 N.Y.S.2d 985, 987-88 (Crim. Ct. 1974). Relying in part on these New York precedents, a California appellate court similarly ruled that "[a] condition of restitution in a sentence of probation is a part of the judgment of conviction. It does not create a debt nor a debtor/creditor relationship between the persons making and receiving restitution." *People v. Washburn*, 97 Cal. App. 3d 621, 158 Cal. Rptr. 822, 825 (1979).

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[6] Although this passage refers to criminal sanctions as not dischargeable and does not precisely refer to them as nondebts, the 1898 Bankruptcy Act contained no specific exception to discharge for fines and penalties, *see* 11 U.S.C. § 35a (Bankruptcy Act § 17a) (repealed 1979); App. to Br. at 3A, and thus the passage in Collier at a minimum suggests that the courts had devised ways to exempt criminal fines and penalties from bankruptcy notwithstanding the absence of any clear language in the Act authorizing them to do so. In 1984 Collier put the matter in these terms:

> The Bankruptcy Act made no specific provision concerning the dischargeability of fines and penalties due to a governmental unit, but certain principles became well settled in this respect. Fines for violation of law, and forfeiture were not provable and therefore held to be not dischargeable. Generally, fines and penalties were not affected by discharge.

3 Collier on Bankruptcy ¶ 523.17 (15th ed. 1984) (footnotes omitted).

As mentioned earlier, § 57j of the Act provided for the disallowance of debts owing to the United States or any state for a penalty or forfeiture. 11 U.S.C. § 93j (repealed 1979); App. to Br. at 4A. The concept of allowance under the Act referred to acceptance of the claim by the courts. The courts, however, could only allow what were called "provable" debts. A provable debt, as defined in § 63a of the Act, 11 U.S.C. § 103a (repealed 1979); App. to Br. at 4A, was one that, among other things, represented a fixed liability evidenced by a judgment or instrument in writing. Since the courts could only allow or disallow a claim if the creditor had first proved it, the reference in § 57j to the disallowance of penalties and forfeitures was not a provision making these obligations nondischargeable but rather one that served only to disallow those limited types of penalties, such as tax penalties, that could be proved in the first place. 3 Collier on Bankruptcy ¶¶ 57.02, 57.22 (14th ed. 1977). In fact, disallowed but provable debts were discharged pursuant to 11 U.S.C. § 35a (Bankruptcy Act § 17a) (repealed 1979); App. to Br. at 3A. As Collier points out in the paragraph just quoted, however, "[f]ines for violation of law, and forfeiture were not provable and therefore held not to be dischargeable."

2. With the exception of this last California case, which came down on October 11, 1979, eleven days after the new Code took effect, *see Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 53 n.1 (1982), Congress in enacting the Bankruptcy Code was presumptively familiar with the conclusion of these cases that criminal sanctions were not bankruptcy debts. "[W]here, as here, Congress adopts a new law incorporating sections of a prior law, Congress normally can be presumed to have had knowledge of the interpretation given to the incorporated law, at least insofar as it affects the new statute." *Lorillard v. Pons*, 434 U.S. 575, 581 (1978). "It is always appropriate to assume that our elected representatives, like other citizens, know the law." *Cannon v. University of Chicago*, 441 U.S. 677, 696-97 (1979).[7]

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[7] Congress was also obviously aware that federal law had authorized restitution as a condition of probation since 1925. *See United States v. Brown*, 744 F.2d at 911 (citing 43 Stat. 1259, 1260 (1925) (codified as revised at 18 U.S.C. § 3651)).

Congress in considering and passing the Bankruptcy Code of 1978 did absolutely nothing to upset the settled view of the courts that criminal sanctions were not debts. Congress had very different purposes in mind. The major purpose of the bill was "the modernization of the bankruptcy laws." H.R. Rep. No. 595, 95th Cong., 2d Sess. 3, *reprinted in* 1978 U.S. Code Cong. & Ad. News 5965. Substantively the new Code sought to deal with the widespread adoption of the Uniform Commercial Code in the 1960's, the vast spread of commercial credit, and the lack of uniformity in the law concerning business reorganizations. H.R. Rep. No. 595, 95th Cong. 2d Sess. 3-5, *reprinted in* 1978 U.S. Code Cong. & Ad. News 5965-66. Procedurally the Code served to replace a strained and somewhat unregulated bankruptcy referee system with the creation of federal bankruptcy courts and federal bankruptcy judges. *Id.; see also Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. at 52-56. Nothing in the materials discussing the passage of the Code in 1978 even remotely suggests that Congress sought to tamper with the prevailing rule of the courts that criminal sanctions with monetary consequences did not constitute bankruptcy debts. *Cf. Bryan v. Itasca County*, 426 U.S. 373, 380-81 (1976) ("provision for state criminal jurisdiction over offenses committed by or against Indians on the reservations was the central focus of Pub. L. 280 . . . . In marked contrast in the legislative history is the virtual absence of expression of congressional policy or intent respecting § 4's grant of civil jurisdiction to the states").

3. Not only did Congress register no dissatisfaction with the judicially created criminal law exception to the definition of debt, but it affirmatively expressed its approval of the underlying policy that had spawned this exception. The House Report on the 1978 bill makes clear the position of Congress that "[t]he bankruptcy laws are not a haven for criminal offenders, but are designed to give relief from financial overextension. Thus, criminal actions and proceedings may proceed in spite of bankruptcy." H.R. Rep. No. 595, 95th Cong., 2d Sess. 342, *reprinted in* 1978 U.S. Code Cong. & Ad. News

6299. It is true, of course, as the Court of Appeals emphasized, that this statement appears not in the legislative history of the Code sections defining "debt" and "claim" but rather in the explanation of the 11 U.S.C. § 362(b)(1) exception to the automatic stay for "the commencement or continuation of a criminal action or proceeding against the debtor." 11 U.S.C. § 362(b)(1); Pet. at ix; App. to Pet. at 44A–46A. But the Court of Appeals erred in concluding that this statement provides no indication of an intention to exclude obligations arising out of criminal activities from the term "debt." App. to Pet. at 44A. First, the fact that there exists an express criminal law exception to and accompanying legislative history regarding the automatic stay in no way undermines the inference of a similar exception to the definition of "debt," since the judicially created criminal law exception to "debt" had become firmly established by 1978 whereas "in enacting § 362 in 1978, Congress significantly broadened the scope of the automatic stay . . . [and] it was necessary for Congress to limit this new power expressly." *Midlantic National Bank v. New Jersey Department of Environmental Protection*, 106 S. Ct. at 761. Second, one cannot reasonably assume that Congress intended to exempt criminal proceedings from the automatic stay and at the same time provide for the partial invalidation of criminal proceedings by discharge of a restitution order. No useful purpose would be served by allowing the continuation of a criminal prosecution only to nullify in part its result. Moreover, discharge of a criminal restitution order—an order imposed after a court has found a person guilty of a crime beyond a reasonable doubt—has little to do with the goal of providing distressed debtors "relief from financial over-extension." In short, the statement of Congress that the bankruptcy laws are not "a haven for criminal offenders" expressed a general principle applicable to the bankruptcy scheme and fully supports an interpretation interpretation of "debt" that would exclude criminal monetary obligations.[8]

Congress thus acted in 1978 in full view of a judicially created criminal law exception to the concept of bankruptcy debts. If Congress had desired to change this rule of law, "it [would have] ma[d]e[ ] that intent specific." *Midlantic National Bank v. New Jersey Department of Environmental Protection*, 106 S. Ct. at 759-60. It did not do so. The only available expression in the legislative history suggests the unwillingness of Congress to extend the relief available under the Bankruptcy Code to persons subject to criminal sanctions.

C. Public Policy Considerations

1. This Court should always strive to interpret an Act of Congress in accordance with general public policy. *See Midlantic National Bank v. New Jersey Department of Environmental Protection*, 106 S. Ct. at 762 (construing the Bankruptcy Code in conformance with "repeated congressional emphasis on its 'goal of protecting the environment against toxic pollution' "). Contrary to this approach, the decision below, insofar as it holds that a state criminal restitution order is a bankruptcy debt, conflicts frontally with the general doctrine in public policy, enunciated in *Younger v. Harris*, 401 U.S. 37 (1971), that federal courts, including

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[8] Criminal obligations are apparently not the only implied exception to the term "debt." As part of his remarks upon introduction of the Senate amendment to the bankruptcy reform act proposed by the House, Senator DeConcini observed that the term "debt" does not include a policy loan made by an insurance company. To have made an express exception to the term "debt" for such loans, according to Senator DeConcini, "would have required elaboration of other legal relationships not arising by a liability on a claim." 124 Cong. Rec. 33992 (statement of Sen. DeConcini), *reprinted in* 1978 U.S. Code Cong. & Ad. News 6507. Senator DeConcini did not specify any of the "other legal relationships," but his statement clearly suggests that several exist.

Younger condemned. Thus *Younger* principles remain fully applicable here and they should inform this Court's interpretation of the Bankruptcy Code.[9]

2. The construction of the Code by the Court of Appeals also produces decidedly absurd results, as the concurring opinion essentially acknowledged. The ruling below allows Robinson to steal from the government and pay off her creditors with the money she stole. The court's decision allows for the growth of a revolving door system of justice whereby a defendant convicted of a crime in state criminal court can merely walk across the street to federal bankruptcy court and escape justice.

This Court should not presume that Congress intended such an absurd result. *Griffin v. Oceanic Contractors, Inc., supra.* Congress specifically provided for the exception from discharge of certain taxes, fraudulently-created debts, alimony and child support payments, debts arising from willful injury, tax fines and penalties, student loans, and debts incurred as a result of drunk driving. 11 U.S.C. § 523(a); Pet. at x–xvii. While Congress apparently characterized these obligations as debts not subject to discharge rather than obligations not bankruptcy courts, should not interfere with pending criminal prosecutions in the states. *See Barnette v. Evans,* 673 F.2d at 1251-52. As the *Younger* court stated, "the National Government, anxious though it may be to vindicate and protect federal rights and federal interests, [should] always endeavor[ ] to do so in ways that will not unduly interfere with the legitimate activities of the States." 401 U.S. at 44. The interpretation given the Bankruptcy Code by the Court of Appeals dramatically compromises the objectives of the *Younger* doctrine by allowing a federal bankruptcy court to nullify the enforcement of a valid final judgment of a state criminal court. *See Huffman v. Pursue, Ltd.*, 420 U.S. 592, 599 (1975) (applying *Younger* to attempts to enjoin enforcement of state civil nuisance judgment). One cannot easily imagine that this result furthers "the purposes Congress sought to serve," *Chapman v. Houston Welfare Rights Organization, supra,* or that it reflects, in the words of the Court of Appeals, the "priorities established by Congress" in enacting the bankruptcy laws.

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[9] The *Younger* doctrine does not, of course, leave a debtor helpless in the occasional case in which the animus of the state prosecution is "neither punishment nor a sense of public duty, but rather [a desire] to obtain payment of a dischargeable debt either by an order of restitution or by compromise of the criminal charge upon payment of the civil obligation." *In re Taylor,* 16 B.R. 323, 326 (Bankr. D. Md. 1981). In such a case the debtor can normally challenge the bona fides of the prosecution in state court, as the Third and Eleventh Circuits have explained. *In re Davis,* 691 F.2d at 178; *Barnette v. Evans,* 673 F.2d at 1252. But if state remedies are ineffective or it is evident that the state prosecution is brought in bad faith or for purposes of harassment, *In re Davis,* 691 F.2d at 178, then a bankruptcy court can and should assume jurisdiction pursuant to 11 U.S.C. § 105(a) and enjoin the participants in the state prosecution. *Id.* at 177 & n.5; *In re Wise,* 25 B.R. 440, 441–42 (Bankr. E.D. Va. 1972); Pet. at vi. In the case at bar, the state court imposed restitution well before the petition in bankruptcy and Robinson has never suggested that the state did not bring its criminal prosecution against her in good faith.

The respondent argued in opposition to certiorari that *Younger* principles do not apply in this case because the Connecticut Superior Court ordered a stay of probation revocation proceedings during the pendency of this federal litigation. Br. in Opp. at 14-15. The fact that the parties and the state court chose to defer to federal resolution of the issue presented in this case, however, hardly eliminates the concerns underlying *Younger.* On the contrary, the stay issued by the state court serves to highlight the direct confrontation between two independent judicial systems that might otherwise have arisen.

Were this Court to rule that restitution is dischargeable in bankruptcy, then in every subsequent case in which a person ordered to make restitution in state court petitioned for bankruptcy, a federal court would have to assume the role of enjoining state court enforcement of state criminal law. Such a situation represents precisely the type of undue "interfere[nce] with the legitimate activities of the States" that qualifying as debts, these obligations, unlike criminal sanctions, were expressly made nondischargeable debts by § 17a of the 1898 Bankruptcy Act and did not carry with them at the time of the drafting of the Code in 1978 a history of treatment by the courts as nondebts. 11 U.S.C. § 35a (repealed 1979). App. to Br. at 3A. Thus it was logical for Congress to continue this approach by excluding these civil obligations from bankruptcy by way of the exceptions to discharge in 11 U.S.C. § 523 while at the same time excluding criminal sanctions from bankruptcy by leaving untouched their historic status as nondebts. It would have reflected little logic, however, for Congress to have exempted such civil obligations as child support from bankruptcy while allowing a bankrupt to discharge criminal restitution.

The respondent's answer is that the state need only file a timely objection to discharge pursuant to § 523(a), which the state did not do in this case. This proposal cannot possibly comport with the Congressional design for exempting criminal sanctions from discharge. As a general matter, when a state court has already adjudicated an individual guilty of a crime beyond a reasonable doubt, state prosecutors should not then have to shoulder the added burden of learning the intricacies of bankruptcy law, filing a complaint in federal court, paying filing fees, participating in discovery, engaging in motion practice, and, in some instances, proving their case over again, simply to ensure that a convicted criminal does not escape the punishment that the criminal court imposed. *See* Bankruptcy Rules 4004(d), 4005, 7001 et seq. As this Court stated in discussing the rule of prosecutorial damages immunity: "if the prosecutor could be made to answer in court each time . . . a person charged him with wrong-doing, his energy and attention would be diverted from the pressing duty of enforcing the criminal law." *Imbler v. Pachtman*, 424 U.S. 409, 425 (1976).

The fact that the debtor will have pleaded guilty or that a jury will have found the debtor guilty of an offense beyond a reasonable doubt will not necessarily lessen the prosecution's burden in bankruptcy court of proving the state's claim to restitution. Even assuming that the criminal court's finding of guilt will have res judicata effect in bankruptcy court, the description of the crime in the state court judgment—e.g. forgery or issuing a bad check, *see* Conn. Gen. Stat. §§ 53a-128, 53a-138—may not precisely match the phraseology of the Bankruptcy Code's exceptions to discharge—e.g. "fraud" or "larceny," *see* 11 U.S.C. § 523(a)(4)—thus requiring the prosecution to present at least some additional proof that the state restitution order arises from a debt excepted from discharge by the Code. More significantly, perhaps, with respect to the amount of restitution, the state will undoubtedly have to prove its case from the start. A sentencing court in imposing restitution is not bound by the amount of the defendant's gain charged in the indictment or found by the jury but instead may order restitution in an amount that, based on its discretion and the usually flexible procedures applicable at sentencing, reflects the victim's loss and otherwise satisfies the government's interest in deterrence, retribution, and rehabilitation. *See, e.g., United States v. Lemire,* 720 F.2d 1327, 1352-53 (D.C. Cir. 1983), *cert. denied,* 104 S. Ct. 2678 (1984); *State v. Gunther,* 39 Conn. Supp. 504, 466 A.2d 804, 808 (App. Sess. 1983). *See generally United States v. Grayson,* 438 U.S. 41, 49 (1978); *Williams v. New York,* 337 U.S. 241 (1949). In Connecticut and elsewhere a sentencing court, especially as part of a plea bargain, may also base a sentence on reliable information concerning charges that the government has dropped or not prevailed upon. *See United States v. Davies,* 683 F.2d 1052 (7th Cir. 1982); *State v. Huey,* 199 Conn. 121, 126-27, ___A.2d___ (1986). These sentencing determinations will not have res judicata effect. *United States v. Brown,* 744 F.2d at 910. Hence in all these cases the same prosecutor who obtained a conviction in criminal court, either by plea or by trial, may then have to prove the government's entitlement to the full amount of restitution in a second or at least more formal trial in bankruptcy court. Depending on when bankruptcy proceedings commenced, this second trial might take place several years after the criminal proceedings, thus exacerbating the prosecutor's burden of proof and conflicting with the strong policy favoring finality of criminal judgments. *See Engle v. Isaac*, 456 U.S. 107, 127 (1982). The true irony is that while the double jeopardy clause normally prohibits a second criminal trial after judgment, *North Carolina v. Pearce*, 395 U.S. 711, 717 (1969), the respondent's proposal would in effect require one.

The respondent's proposal, moreover, even if workable in some cases, would merely narrow the existing loophole without eliminating it. Although an exception to discharge exists for debts created by "fraud . . . embezzlement, or larceny," 11 U.S.C. § 523(a)(4), and "willful and malicious injury by the debtor to another entity or to the property of another entity," *id.* § 523(a)(6), no exception exists that would prevent the discharge of restitution in cases involving common state crimes such as reckless manslaughter, Conn. Gen. Stat. § 53a-56(a)(1), criminally negligent homicide, *id.* § 53a-58, reckless assault with a deadly weapon, *id.* § 53a-60(a)(3), negligent assault with a deadly weapon, *id.* § 53a-61(a)(3), reckless burning, *id.* § 53a-114, bribery, *id.* § 53a-147, receiving kickbacks, *id.* § 53a-161c, cruelty to animals, *id.* § 53-247, or professional gambling, *id.* § 53-278b. *See, e.g.*, S. Rep. 989, 95th Cong., 2nd Sess. 79, *reprinted in* 1978 U.S. Code Cong. & Ad. News 5865 (exception to discharge for debts created by "willful or malicious" conversion or injury does not encompass acts done in "reckless disregard" of consequences).[10]

The respondent may reply, as she did in opposition to certiorari, that the existence of gaps and crevices in her proposal means merely that in those instances the policies established by Congress in the Bankruptcy Code prevail over the interests of the criminal justice system. Br. in Opp. at 13–14. According to the respondent, then, the fact that a state has no recourse to prevent the discharge of, for example, a $100,000 criminal restitution order imposed as a result of a criminal's reckless burning is just the price society must pay for the existence of the bankruptcy laws.

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[10] The respondent's proposal assumes not only that restitution is a debt, but also that restitution, when imposed, for example, in a larceny case, is a "debt . . . for . . . larceny" within the terms of § 523(a)(4) rather than a separate obligation that supersedes the original larceny debt to the victim. *See In re Brown*, 39 B.R. at 823 (leaving this question open).

The State of Connecticut takes a different view. We believe that criminals, not society, should pay for crime. Surely Congress in enacting the Bankruptcy Code did not disagree. Undoubtedly it recognized "society's compelling interest in finding, convicting, and punishing those who violate the law." *Moran v. Burbine, supra.* Thus the wholly inadequate scheme devised by the respondent for enforcing restitution orders jeopardized by bankruptcy cannot possibly reflect "the priorities established by Congress." The construction of the Code most consistent with its language, its history, and with public policy is that restitution is not a debt.

II. ALTERNATIVELY, EVEN IF A CRIMINAL RESTITUTION ORDER IS A DEBT, IT IS EXCEPTED FROM DISCHARGE BY § 523(a)(7)

Section 523(a)(7) of the Code provides an exception to discharge "to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss." Unlike the exceptions to discharge for debts arising from false pretenses, larceny, or willful injury to person or property, § 523(a)(7) contains no time limits on its effectiveness. 11 U.S.C. § 523(c); Pet. at xviii.

The Court of Appeals held that, although restitution is a "penalty" and in this case was "payable to and for the benefit of a governmental unit," restitution was at least partly compensatory and thus did not satisfy the subparagraph (a)(7) requirement that the penalty "not [be] compensation for actual pecuniary loss." The court focused on the fact that a Connecticut court can order an offender to make restitution in an amount "he can afford to pay or provide in a suitable manner, *for the loss or damage caused thereby*," Conn. Gen. Stat. § 53a-30(a)(4); App. to Br. at 6A (emphasis in court's opinion), and that the restitution order here of $9,932.95 equaled the precise amount of the loss. App. to Pet. at 48A–53A.

The petitioners believe that this analysis does not accurately characterize the nature of criminal restitution, either in this case or in general, and that it does not interpret the Code in accordance with the intent of Congress. Thus even if this Court should find that criminal restitution constitutes a debt, it should also find that it falls within the § 523(a)(7) exception to discharge.[11]

1. The restitution order in this case was unusual in that, while the state court nominally ordered restitution in the amount of the $9,932.95 loss to the state, the total payments Robinson would have had to make at the rate of $100.00 per month through the end of her probationary period would have amounted only to $5,800.00. Thus under no circumstances would the state have received full compensation for its loss. In any event, even in a case in which the restitutionary amount more clearly matched the pecuniary loss, the conclusion that restitution represents compensation would not follow. The equation of the restitutionary amount with the pecuniary loss means only that the punishment fits the crime. Certainly it would make little sense for a sentencing court to order restitution in an amount wholly unrelated to the magnitude of the

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[11] Whether restitution in a case involving a private victim is "payable to and for the benefit of a governmental unit" is a question not before the Court. It does not appear, however, that the position advanced above would necessarily lead to the result that restitution is nondischargeable in cases involving a governmental victim but dischargeable in cases involving a private victim. The Code defines "governmental unit" to include not only a "department, agency, or instrumentality of the United States [or] a State," but also the "United States" and the "State" itself. 11 U.S.C. § 101(21). Restitution even in a private victim case is "payable to and for the benefit of a governmental unit" because the probationer initially makes payments to the state, App. to Pet. at 12A, and because restitution in all cases "vindicat[es] society's interest in peaceful retribution." *United States v. Brown*, 744 F.2d at 909.

victim's loss. If restitution is to "vindicat[e] society's interest in peaceful retribution," *United States v. Brown*, 744 F.2d at 909, then the restitution order will necessarily bear a reasonable relationship to the amount of the loss.

2. Moreover, restitution, whether equal to the amount of the loss or not, is "not compensation for actual pecuniary loss" within the meaning of § 523(a)(7). While compensation may represent a consequence of restitution, it is not truly its purpose. *United States v. Carson, supra.* "Although restitution may appear to share with the civil law the aim of compensation, close examination reveals that its principal goal is not its ability to make the victims whole, but rather its utility as a corrective device." Note, *Victim Restitution in the Criminal Process: A Procedural Analysis, supra.* Restitution in this sense resembles liability for the costs of prosecution, which several lower federal courts, apparently without disagreement, have held excepted from discharge under § 523(a)(7) despite the superficially compensatory character that costs may possess. *In re Zarzynski*, 771 F.2d 304 (7th Cir. 1985); *In re Cox*, 33 B.R. 657 (Bankr. M.D. Ga. 1983).

The resolution of whether § 523(a)(7) can include restitution within its exception to discharge must, of course, take into account the available aids to construction of the Code. Thus this Court must read § 523(a)(7) in view of the fact that Congress in enacting the bankruptcy laws sought primarily to "relieve the honest debtor from the weight of oppressive indebtedness," *Williams v. United States Fidelity & Guaranty Co., supra*, that it had no intention of creating "a haven for criminal offenders," H.R. Rep. No. 595, *supra*, that a federal court discharge of a state criminal restitution order would constitute undue federal interference in the administration of criminal justice in the states, *Younger v. Harris, supra*, and that the discharge of criminal restitution would create the absurd result in this case and many others that a state cannot make a criminal pay for her crime in the most meaningful manner. *Chapman v. Houston Welfare Rights Organization, supra.* Viewing the matter in this light, this Court can and, if it reaches the issue, should interpret § 523(a)(7) to prevent the discharge of a sentence of criminal restitution.[12]

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[12] Significant doubt exists as to whether the state could revoke Robinson's probation if this Court found restitution to represent a dischargeable debt. Section 525 of the Code makes it illegal for a governmental unit to "deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to . . . a person . . . solely because such bankrupt . . . has not paid a debt that is dischargeable." 11 U.S.C. § 525(a); App. to Br. at 2A. This section codifies the result in *Perez v. Campbell*, 402 U.S. 637 (1971), which held that a state cannot refuse to renew a driver's license solely because the driver had not paid a tort judgment discharged in bankruptcy. Moreover, "[t]he section is not exhaustive. The enumeration of various forms of discrimination against former bankrupts is not intended to permit other forms of discrimination." S. Rep. No. 989, 95th Cong., 2d Sess. 81, *reprinted in* 1978 U.S. Code Cong. & Ad. News 5867. *Cf. Beardon v. Georgia*, 461 U.S. 660 (1983) (prohibiting a state from revoking probation solely because of probationer's bona fide inability to pay fine or restitution unless no other method will satisfy the state's penological interests).

CONCLUSION

For the foregoing reasons, this Court should reverse the judgment of the United States Court of Appeals for the Second Circuit.

Respectfully submitted.

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In The
Supreme Court Of The United States

OCTOBER TERM, 1985

JOHN J. KELLY,
CONNECTICUT CHIEF STATE'S ATTORNEY, ET AL.,
Petitioners,

v.

CAROLYN ROBINSON,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

APPENDIX TO BRIEF OF PETITIONERS
(Containing Statutes Involved in addition to those reprinted in the Appendix to the Petition)

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STATUTES INVOLVED

(in addition to those reprinted in the Appendix to the Petition)

11 U.S.C. § 524. Effect of discharge

(a) A discharge in a case under this title—

(1) voids any judgment at any time obtained, to the extent that such judgment is a determination of the personal liability of the debtor with respect to any debt discharged under section 727, 944, 1141, or 1328 of this title, whether or not discharge of such debt is waived;

(2) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived; and

(3) operates as an injunction against the injunction against the commencement or continuation of an action, the employment of process, or an act to collect or recover from, or offset against, property of the debtor of the kind specified in section 541(a)(2) of this title that is acquired after the commencement of the case, on account of any allowable community claim, except a community claim that is excepted from discharge under section 523 or 1328(c)(1) of this title, or that would be so excepted, determined in accordance with the provisions of sections 523(c) and 523(d) of this title, in a case concerning the debtor's spouse commenced on the date of the filing of the petition in the case concerning the debtor, whether or not discharge of the debt based on such community claim is waived.

11 U.S.C. § 525. Protection against discriminatory treatment

(a) Except as provided in the Perishable Agricultural Commodities Act, 1930 (7 U.S.C. 499a-499s), the Packers and Stockyards Act, 1921 (7 U.S.C. 181–229), and section 1 of the Act entitled "An Act making appropriations for the Department of Agriculture for the fiscal year ending June 30, 1944, and for other purposes," approved July 12, 1943 (57 Stat. 422; 7 U.S.C. 204), a governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to, condition such a grant to, discriminate with respect to such a grant against, deny employment to, terminate the employment of, or discriminate with respect to employment against, a person that is or has been a debtor under this title or a bankrupt or a debtor under the Bankruptcy Act, or another person with whom such bankrupt or debtor has been associated, solely because such bankrupt or debtor is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, has been insolvent before the commencement of the case under this title, or during the case but before the debtor is granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act.

(b) No private employer may terminate the employment of, or discriminate with respect to employment against, an individual who is or has been a debtor under this title, a debtor or bankrupt under the Bankruptcy Act, or an individual associated with such debtor or bankrupt, solely because such debtor or bankrupt—

(1) is or has been a debtor under this title or a debtor or bankrupt under the Bankruptcy Act;

(2) has been insolvent before the commencement of a case under this title or during the case but before the grant or denial of a discharge; or

(3) has not paid a debt that is dischargeable in a case under this title or that was discharged under the Bankruptcy Act.

11 U.S.C. § 35a. (Bankruptcy Act § 17a) (repealed 1979). Dischargeability of Debts—Debts Not Affected by Discharge

a. A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part except such as (1) are taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankruptcy. *Provided, however,* That a discharge in bankruptcy shall not release a bankrupt from any taxes (a) which were not assessed in any case in which the bankrupt failed to make a return required by law, (b) which were assessed within one year preceding bankruptcy in any case in which the bankrupt failed to make a return required by law, (c) which were not reported on a return made by the bankrupt and which were not assessed prior to bankruptcy by reason of a prohibition on assessment pending the exhaustion of administrative or judicial remedies available to the bankrupt, (d) with respect to which the bankrupt made a false or fraudulent return, or willfully attempted in any manner to evade or defeat, or (e) which the bankrupt has collected or withheld from others as required by the laws of the United States or any State or political subdivision thereof, but has not paid over; but a discharge shall not be a bar to any remedies available under applicable law to the United States or to any State or any subdivision thereof, against the exemption of the bankrupt allowed by law and duly set apart to him under this Act: *And provided further,* That a discharge in bankruptcy shall not release or affect any tax lien; (2) are liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive, or for willful and malicious conversion of the property of another; (3) have not been duly scheduled in time for proof and allowance, with the name of the creditor if known to the bankrupt, unless such creditor had notice or actual knowledge of the proceedings in bankruptcy; (4) were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity; (5) are for wages and commissions to the extent that they are entitled to priority under subdivision a of section 64 of this Act; (6) are due for moneys of an employee received or retained by his employer to secure the faithful performance by such employee of the terms of a contract of employment; (7) are for alimony due or to become due, or for maintenance or support of wife or child, or for seduction of an unmarried female or for breach of promise of marriage accompanied by seduction, or for criminal conversation; or (8) are liabilities for willful and malicious injuries to the person or property of another other than conversion as excepted under clause (2) of this subdivision.

11 U.S.C. § 93j (Bankruptcy Act § 57j) (repealed 1979) Proof and Allowance of Claims

j. Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interests as may have accrued on the amount of such loss according to law.

11 U.S.C. § 103a (Bankruptcy Act § 63a) (repealed 1979) Debts Which May Be Proved

a. Debts of the bankrupt may be proved and allowed against his estate which are founded upon (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition by or against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; (2) costs taxable against a bankrupt who was at the time of the filing of the petition by or against him plaintiff in a cause of action which would pass to the trustee and which the trustee declines to prosecute after notice; (3) a claim for taxable costs incurred in good faith by a creditor before the filing of the petition in an action to recover a provable debt; (4) an open account, or a contract express or implied; (5) provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for a discharge, less costs incurred and interest accrued after the filing of the petition and up to the time of the entry of such judgments; (6) an award of an industrial-accident commission, body, or officer of any State having jurisdiction to make awards of workmen's compensation in case of injury or death from injury, if such injury occurred prior to adjudication; (7) the right to recover damages in any action for negligence instituted prior to and pending at the time of the filing of the petition in bankruptcy; (8) contingent debts and contingent contractual liabilities; or (9) claims for anticipatory breach of contracts, executory in whole or in part, including unexpired leases of real or personal property: *Provided, however,* That the claim of a landlord for damages for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after bankruptcy, plus an amount equal to the unpaid rent accrued, without acceleration, up to such date: *And provided further,* That in the case of an assignment of any such claim for damages, the court shall, in determining the amount thereof, examine the circumstances of the assignment and the consideration paid or to be paid therefor, and may allow the claim of the assignee in such amount, subject to the provisions of the foregoing proviso of this clause (9), as will be fair and equitable.

Conn. Gen. Stat. Sec. 53a-30. Conditions of probation and conditional discharge. (a) When imposing sentence of probation or conditional discharge, the court may, as a condition of the sentence, order that the defendant: (1) Work faithfully at a suitable employment or faithfully pursue a course of study or of vocational training that will equip him for suitable employment; (2) undergo medical or psychiatric treatment and remain in a specified institution, when required for that purpose; (3) support his dependents and meet other family obligations; (4) make restitution of the fruits of his offense or make restitution, in an amount he can afford to pay or provide in a suitable manner, for the loss or damage caused thereby and the court may fix the amount thereof and the manner of performance; (5) if a minor, (A) reside with his parents or in a suitable foster home, (B) attend school, and (C) contribute to his own support in any home or foster home; (6) post a bond or other security for the performance of any or all conditions imposed; (7) refrain from violating any criminal law in the United States, this state or any other state; (8) reside in a residential community center or halfway house approved by the commissioner of correction, and contribute to the cost incident to such residence; (9) satisfy any other conditions reasonably related to his rehabilitation. The court shall cause a copy of any such order to be delivered to the defendant and to the probation officer, if any.

(b) When a defendant has been sentenced to a period of probation, the office of adult probation may require that the defendant comply with any or all conditions which the court could have imposed under subsection (a) which are not inconsistent with any condition actually imposed by the court.

(c) At any time during the period of probation or conditional release, after hearing and for good cause shown, the court may modify or enlarge the conditions, whether originally imposed by the court under this section or otherwise, and may extend the period provided the original period with any extensions shall not exceed the periods authorized by section 53a-29. The court shall cause a copy of any such order to be delivered to the defendant and to the probation officer, if any.

Conn. Gen. Stat. Sec. 53a-31. Calculation of periods of probation and conditional discharge. Interruption of period of sentence. Sentence of imprisonment may satisfy sentence of probation or conditional discharge. (a) A period of probation or conditional discharge commences on the day it is imposed, except that, where it is preceded by a sentence of imprisonment with execution suspended after a period of imprisonment set by the court, it commences on the day the defendant is released from such imprisonment. Multiple periods, whether imposed at the same or different times, shall run concurrently.

(b) Issuance of a warrant or notice to appear for violation pursuant to section 53a-32, shall interrupt the period of the sentence as of the date of such issuance until a final determination as to the violation has been made by the court.

(c) In any case where a person who is under a sentence of probation or of conditional discharge is also under an indeterminate sentence of imprisonment, or a sentence authorized under section 18-73 or 18-75, imposed for some other offense by a court of this state, the service of the sentence of imprisonment shall satisfy the sentence of probation or of conditional discharge unless the sentence of probation or of conditional discharge is revoked prior to parole or satisfaction of the sentence of imprisonment.

Conn. Gen. Stat. Sec. 53a-32. Violation of probation or conditional discharge: Arrest; procedure. (a) At any time during the period of probation or conditional discharge, the court or any judge thereof may issue a warrant for the arrest of a defendant for violation of any of the conditions of probation or conditional discharge, or may issue a notice to appear to answer to a charge of such violation, which notice shall be personally served upon the defendant. Any such warrant shall authorize all officers named therein to return the defendant to the custody of the court or to any suitable detention facility designated by the court. Any probation officer may arrest any defendant on probation without a warrant or may deputize any other officer with power to arrest to do so by giving him a written statement setting forth that the defendant has, in the judgment of the probation officer, violated the conditions of his probation. Such written statement, delivered with the defendant by the arresting officer to the official in charge of any correctional center or other place of detention, shall be sufficient warrant for the detention of the defendant. After making such an arrest, such probation officer shall present to the detaining authorities a similar statement of the circumstances of violation. Provisions regarding release on bail of persons charged with a crime shall be applicable to any defendant arrested under the provisions of this section. Upon such arrest and detention, the probation officer shall immediately so notify the court or any judge thereof. Thereupon, or upon an arrest, by warrant as herein provided, the court shall cause the defendant to be brought before it without unnecessary delay for a hearing on the violation charges. At such hearing the defendant shall be informed of the manner in which he is alleged to have violated the conditions of his probation or conditional discharge, shall be advised by the court that he has the right to retain counsel and, if indigent, shall be entitled to the services of the public defender, and shall have the right to cross-examine witnesses and to present evidence in his own behalf.

(b) If such violation is established, the court may continue or revoke the sentence of probation or conditional release or modify or enlarge the conditions, and, if such sentence is revoked, require the defendant to serve the sentence imposed or impose any lesser sentence. No such revocation shall be ordered, except upon consideration of the whole record and unless such violation is established by reliable and probative evidence.

Conn. Gen. Stat. Sec. 53a-33. Termination. The court or sentencing judge may at any time during the period of probation or conditional discharge, after hearing and for good cause shown, terminate probation or conditional discharge.

Senator GRASSLEY. Mr. Siemens.

STATEMENT OF HON. GARY E. SIEMENS

Mr. SIEMENS. Thank you, Senator.

My name is Gary Siemens. I am an assistant deputy attorney general with the State attorney general's office in the Commonwealth of Kentucky.

I am honored to appear today before the subcommittee to testify on behalf of Attorney General David Armstrong and on behalf of Kentucky consumers to state our support for this Senate bill.

This legislation basically strengthens the capabilities of States attorneys generals to enforce State court judgments resulting from flagrant violation of State consumer protection laws. From my background, I am going to be talking in terms of the effect of the bill on consumer protection cases and consumer protection judgments.

Passage of the bill would simply eliminate the requirement now to try fraud cases both in State court and then again in bankruptcy court. Delay tactics wold be stopped. Our court system would respond faster and more effectively to the problems of fraud victims. Consumer fraud defendants would be compelled to face the responsibilities of their conduct.

In lawsuits filed by our consumer protection division in Kentucky for violations of our Consumer Protection Act, approximately one-half of the defendants charged end up in bankruptcy court. They may end up in bankruptcy court before our lawsuit is filed, during the process of the lawsuit being resolved, or after a judgment is returned. Frequently, bankruptcy court is used in negotiations by defense attorneys to try to settle or resolve consumer protection cases. It is being used as a tool it was never intended to be used as. Often the goal is the same—for consumer fraud defendants to rid themselves of the burden of making restitution to consumers victimized by their fraudulent conduct.

The Kentucky Consumer Protection Act outlaws unfair, false, misleading, or deceptive acts or practices in the conduct of trade or commerce. The consumer protection division when we file lawsuits on behalf of the Commonwealth of Kentucky, we generally file those in a convenient forum to all parties. We file those in the county where the deceptive acts occurred. The civil law justice system then proceeds and works as it was intended to work.

However, the filing of the bankruptcy petition for relief by consumer fraud defendants abruptly changes, and sometimes stops completely, the State court proceedings. Motions may need to be filed in the bankruptcy court for relief from the stay provided by the bankruptcy court. Oftentimes the bankruptcy court then issues guidelines on how the State can proceed in the State court proceeding. A complaint as to the dischargeability of the debts involved in the State court lawsuit must be also filed in the bankruptcy court.

Two different courts become involved. Two different sets of rules become involved. Failure to follow one of the rules can result in the dismissal of the State's lawsuit. When the consumer fraud defendant files for bankruptcy, they often choose an inconvenient forum to file the bankruptcy petition for relief. The bankruptcy court in which the petition is filed by the consumer fraud defendant after satisfying the 6-month residency requirement, is often in another State.

In the State court action under the Consumer Protection Act, common law fraud need not be proven. As General Miller stated in his testimony, it holds true in Kentucky that the act or practice is unfair in Kentucky if it is shown to possess a tendency or capacity to deceive consumers. You do not have to prove intent to deceive. The standard of proof is the State must prove its case by a preponderance of the evidence.

In the bankruptcy court, however, the rules are different. The State must prove common law fraud. So a judgment obtained under the Kentucky Consumer Protection Act may have no meaning in trying to enter that judgment in bankruptcy court and very often, as a general rule, does not. The State must prove in bankruptcy court common law fraud that the representation was false when made, that the debtor made the misrepresentation with the intent to deceive, that the creditor or consumer reasonably relied on the misrepresentation, and that the creditor or consumer suffered an injury that was the proximate result of the misrepresentation. The standard of proof in the bankruptcy court proceeding is a higher standard of proof than in the Consumer Protection Act violations. The standard of proof in the bankruptcy proceeding is by clear and convincing evidence.

Bankruptcy courts sometimes become safe places for consumer fraud defendants to escape from State court consumer protection act lawsuits and judgments. Due to time lapses, difficulties in producing evidence and witnesses, and varying standards of proof, consumer protection attorneys and victimized consumers just sometimes give up. The end result sometimes makes State court judgments ordering restitution to consumer victims unenforceable.

During recent months in our consumer protection division, our attorneys have been required to litigate in bankruptcy courts in Florida, Texas, West Virginia, and Arkansas to contest attempts by consumer fraud defendants in our lawsuits to have their obligations under our State court actions discharged. In one case, a defendant entered an agreed order in our State court to provide over $200,000 worth of merchandise, money, and services to over 500 consumers. Later the defendant filed for bankruptcy in Arkansas, it is alleged with complying without the terms of the State court judgment, and seeking to have the debts named in the state court judgment discharged. The problems of distance, availability of witnesses, different standards of proof, and lapse of time are clear. At stake is the consumers' money and the defendant's accountability.

This legislation, we believe, will put consumer fraud defendants on notice that they will be held responsible for their conduct. A State court judgment requiring restitution for violation of the Consumer Protection Act will be nondischargeable under this amendment. The purpose of the Bankruptcy Act, as we have heard the other witnesses describe, is to provide a new opportunity in life and a clear field for future effort. But the act was never intended to allow consumer fraud defendants to twist the bankruptcy law into a convenient hiding place from State law enforcement agencies.

On behalf of General Armstrong and on behalf of Kentucky consumers, I strongly recommend the passage of this bill.

Thank you, sir.

[Statement submitted for the record follows:]

PREPARED STATEMENT OF GARY E. SIEMENS

Mr. Chairman and Members of the Subcommittee:

My name is Gary E. Siemens. I am an Assistant Deputy Attorney General for the Commonwealth of Kentucky. I serve as the Director of the Consumer Protection Division of the Kentucky Attorney General's Office.

I am honored to appear today before the Senate Judiciary Committee, Subcommittee on Courts, on behalf of Hon. David L. Armstrong, Attorney General of the Commonwealth of Kentucky, and on behalf of Kentucky consumers to state our support of S. 2531, the Bankruptcy Antifraud Act. It is a particular honor for me to testify before this subcommittee, which is chaired by Hon. Mitch McConnell, United States Senator from the Commonwealth of Kentucky.

This legislation amending Title 11, Section 523(A) of the United States Code strengthens the capabilities of state Attorneys General to enforce state court judgments resulting from flagrant violations of state consumer protection laws.

Passage of the bill would simply eliminate the requirement now to try fraud cases both in state court and again in bankruptcy court. Delay tactics would be stopped. Our court system would respond faster and more effectively to the problems of fraud victims. Consumer fraud defendants would be compelled to face the responsibilities of their conduct.

In lawsuits filed by our Division for violations of the Kentucky Consumer Protection Act, approximately one-half of the defendants charged end up in Bankruptcy Court. Defendants may file for bankruptcy relief prior to our lawsuits being filed, while our lawsuits are pending in state court, or while we are attempting to execute judgments in state court. Often the goal is the same--to rid themselves of the burden of making restitution to consumers victimized by their fraudulent conduct.

The Kentucky Consumer Protection Act is broadly designed to curtail unfair, false, misleading or deceptive acts or practices in the conduct of trade or commerce. The Attorney General for the Commonwealth is authorized to initiate legal action whenever there is reason to believe that any person is using, has used, or is about to use such acts or practices, and that legal action would be in the public interest.

Legal action by the Consumer Protection Division generally is initiated in the county where the deceptive acts occurred--the county in which the consumers victimized by the fraudulent conduct reside. The forum is generally convenient to all the parties. The civil law justice system proceeds and works as intended.

The filing of the Petition for Relief in Bankruptcy Court by consumer fraud defendants abruptly changes, and sometimes stops, the state court proceedings. Motions may need to be filed in the Bankruptcy Court for relief from the stay provided by the Bankruptcy Court. Guidelines may be issued by the Bankruptcy Court on how the matter should proceed in state court. A complaint as to the dischargeability of the debts involved in the state court lawsuit must be filed in the Bankruptcy Court.

The skills and endurance of the consumer protection attorneys and the victimized consumers are tested, as the litigation has expanded to two (2) courts with two (2) different sets of rules. Failure to follow the rules can result in an unexpected dismissal of the state's lawsuit.

The consumer fraud defendant can choose an inconvenient forum to file his Bankruptcy Petition for relief. The Bankruptcy Court in which the petition is filed by the consumer fraud defendant, after satisfying the six (6) months residency requirement, is often in another state.

In the state court action under the Consumer Protection Act, common law fraud need not be proven. The act or practice is unfair if it is shown to possess a tendency or capacity to deceive consumers. Proof of intent to deceive need not be proven. The state must prove its case by a preponderance of the evidence.

In the Bankruptcy Court, the state must prove common law fraud in seeking to have a debt determined nondischargeable as money or property obtained by false representations. The state must prove the debtor knew the representation was false when made, that the debtor made the misrepresentation with intent to deceive, that the creditor or consumer reasonably relied on the misrepresentation, and that the creditor or consumer suffered an injury that was the proximate result of the misrepresentation. The state must prove its case by clear and convincing evidence.

Bankruptcy Courts sometimes become "safe places" for consumer fraud defendants to escape from state court consumer protection act lawsuits and judgments. Due to time lapses, difficulties in producing evidence and witnesses, and varying standards of proof, consumer protection attorneys and victimized consumers sometimes give up. The end result sometimes makes state court judgments ordering restitution to consumer victims unenforceable.

During recent months, consumer protection attorneys in our Division have been required to litigate in Bankruptcy Courts in Florida, Texas, West Virginia, and Arkansas to contest attempts by consumer fraud defendants to have their obligations under our state court actions discharged. In one case, a defendant entered an Agreed Order in state court to provide over $200,000 worth of merchandise, money, and services to over five hundred (500) consumers. Later, the defendant filed for bankruptcy in Arkansas, it is alleged without complying with the terms of the state court judgment and seeking to have the debts named in the state court judgment discharged. The problems of distance, availability of witnesses, different standards of proof, and lapse of time are clear. At stake is the consumers' money and the defendant's accountability.

This legislation will put consumer fraud defendants on notice that they will be held responsible for their conduct. A state court judgment requiring restitution for violation of the Consumer Protection Act will be nondischargeable under the Bankruptcy Act.

The purpose of the Bankruptcy Act is to provide a new opportunity in life and a clear field for future effort. The Bankruptcy Act was never intended, however, to allow consumer fraud defendants to twist the bankruptcy law into a convenient hiding place from state law enforcement agencies.

On behalf of General Armstrong and on behalf of Kentucky consumers, I strongly recommend the passage of S. 2531.

Senator **Grassley**. Thank you very much and I think if there is one thing that each of you stressed, it is the importance of not compromising the Bankruptcy Code for the honest person. But in this instance, we are going after those people who have been dishonest.

If we could, beyond that, to further put it in perspective, I would like to ask any one of you to respond unless I specifically direct a question to one of you.

In your respective States, can you give me an estimate of either the number of cases or the dollar amount lost to the States in cases where you run up against this restitution loophole?

Mr. **Miller**. Just in the recent past, we have had four significant cases in Iowa. One, the *Iowa Ventilation* case which I mentioned dealing with $1.3 million. Another two cases in the health spa area. One involving $100,000 and another $120,000. In a *Discount Buying Club* case, about $47,000. Just in these four cases, between $1.5 million and $2 million.

In addition to money, there is an intangible which is lost, too. It is the loss of justice felt by people who have been abused in this way. They know that the bankruptcy law was not designed to deal with cheaters by letting them off the hook. They have a rough sense of justice and they know in their hearts that they have been denied justice. This is a cost to them and to society as well.

Senator **Grassley**. Mr. Kelly.

Mr. **Kelly**. Senator, perhaps I could best answer your question by giving you a couple of additional examples from our State.

In one case, a woman was convicted of embezzling $10,800 from her employer and was sentenced to make restitution of the full amount. She then petitioned for bankruptcy. We have filed an objection to discharge in bankruptcy court.

In another case, a defendant was convicted of operating his car without mandatory insurance and with a license suspended because of a previous drunk driving conviction. The court ordered him to pay restitution in excess of $3,300 to the owner of the car that he had hit. He then went into bankruptcy, sought to discharge his restitution. The district court allowed him to do so on the basis of *Kelly* v. *Robinson.* We have appealed that case to the second circuit. It is now being held there pending the Supreme Court's decision.

In addition, we have at least four welfare fraud cases stayed in our State courts pending the outcome of *Kelly* v. *Robinson.* In all four of those cases we have filed objections to discharge in bankruptcy. We also expect it will be just a matter of time depending on the outcome of the litigation before we are flooded with defendants in many types of criminal litigation having restitution orders trying this same additional scam to avoid paying court ordered restitution.

Senator **Grassley**. Mr. Siemens.

Mr. **Siemens**. I do not have a number or a dollar amount. As an estimate, bankruptcy is involved in about half of our cases. It is also used just as a threat in investigations and in litigation that our division is involved in. In settlement negotiations, the threat of bankruptcy is used to try to benefit the position of the defendant. It is just used a procedural tool almost commonplace in our cases.

Senator **Grassley**. How much money would you recover in your division—just in your consumer protection division—for restitution?

Mr. **Siemens**. From January to the present, we have one large case involving about $600,000. I think we are running about $800,000 to $900,000 in recoveries for consumers.

Senator **Grassley**. From each of you, do you see any trend in the use of bankruptcy to avoid restitution? In other words, are there a growing number of debtors using the loophole?

Mr. **Miller**. Unfortunately, Senator, it seems to be catching fire. It is being used more and more all the time. When we learned this summer that you and your subcommittee were concerned about this issue, and we wanted to put together a statement about the problem, we quickly contacted a dozen or so AG's offices. They were all familiar with the problem. They had all dealt with it. They had all been frustrated by it.

We are holding a consumer protection conference for the National Association of Attorney Generals in a few weeks. About 40 percent of this conference is going to be devoted to bankruptcy matters.

As Mr. Kelly pointed out, bankruptcy law is a very complicated area. It is becoming so common a problem in consumer protection, and it is so complicated, that we have to spend 40 percent of our conference dealing with bankruptcy now.

Senator **Grassley**. Would the other two agree basically with that?

Mr. **Kelly**. I would be in substantial agreement with that statement. Yes.

Mr. **Siemens**. Yes, and we had to assign one attorney in our division to specialize in bankruptcy and she spends probably 60 to 75 percent of her time doing nothing but litigation in bankruptcy.

Senator **Grassley**. I would like to have you distinguish court ordered restitution from other debts commonly discharged in the usual chapter 7 or chapter 13 cases. In other words, what is so special about restitution owed to a State that we should except it from discharge?

Mr. **Miller**. I think the nature of the debt is different. Bankruptcy was designed for, you might say, the common run-of-the-mill debt on the business side where, for example, you start a business and you do it in good faith, but it does not work out. Bankruptcy is an appropriate solution to this kind of debt.

It is also appropriate when dealing with the personal bankruptcy as well. People who overextend themselves and for whatever reason run up some debts. Then bankruptcy is designed for this situation. Debts that you really accumulate through bad luck, misfortunate, miscalculation.

It is not designed for debts which are brought about by the kind of intent, the kind of debt we are talking about here, by committing a violent crime, by setting out to perpetrate a consumer fraud, by polluting the environment and being able to be relieved of the consequences. The nature of the debt is different. Indeed, the nature of these kinds of debts is similar to those that are not dischargeable now—the back taxes, the child support, alimony—those sorts of things.

Mr. **Kelly**. Mr. Senator, I would agree with that. Congress' intent in passing the bankruptcy laws was to give relief from honest, good faith financial misfortunes on the part of people. It was not designed to be a haven for criminal defendants who intentionally go out, hurt others either physically or monetarily, and then can use the bankruptcy laws or a loophole therein to escape a validly entered State court order.

Mr. **Siemens**. I also agree. It is the nature of the debt. The States have defined fraud based on case law or statutory law themselves and then to have to relitigate on a second definition of what fraud is, is just not fair.

Senator **Grassley**. Tom, how often is standing to bring the complaint against discharge been at issue in your experience?

Mr. **Miller**. How often, Senator?

Senator **Grassley**. Yes, how often has standing been at issue?

Mr. **Miller**. It is an issue that is really starting to catch hold now after the *In Re Cannon* case.

Senator **Grassley**. But so far, it has not affected you?

Mr. **Miller**. It has affected us now in the *Iowa Ventilation* case that I referred to before.

Senator **Grassley**. But it is growing?

Mr. **Miller**. It is certainly growing. *In Re Cannon* is a recent case. A case that maybe surprised us a little bit. But it is going to grow just as the general problems started to grow 2 or 3 years ago. And it is a deadly problem for the attorney general's office in the sense that we are knocked out of court. If we do not have standing, we cannot even help the consumers where they need it the most—in the bankruptcy court where the money really is at stake in the particular instance.

Senator **Grassley**. Again, Tom, with respect to the *Cannon* case, would it be proper for Congress to specifically grant standing to the States' attorneys general or should be left to State law?

Mr. **Miller**. That is an option that you might consider. However, if your legislation, as proposed, and as I understand it, is adopted, it may well not be necessary in the sense that these kinds of debts which we are talking about would automatically pass through the bankruptcy. These debts would be treated like back taxes, child support, or alimony and not need to be litigated. Therefore standing would not be an issue or a problem.

Senator **Grassley**. Section 523(a)(7) excepts from discharge debts that are for a fine or penalty payable to the government. I would like to have you explain why this section, standing all by itself, is not enough to prevent the discharge of court-ordered restitution?

Mr. **Miller**. It probably is one of those situations where we take care of government, but we do not take care of the people. Perhaps if the State has some sort of fine or penalty that would accrue to the State, it would not be dischargeable. But what we are really concerned about, and what is much more important, are those things which the State goes after on behalf of its citizens—the restitution situation, the consumer fraud situation. These are the kinds of things now that look to be dischargeable.

So let us make sure we take care of the people as well as the State government as an institution.

Senator **Grassley**. As a practical matter, if we make these debts nondischargeable and, if the debtor is truly insolvent, what happens to the State's claim? What is the likelihood of being repaid by the debtor?

Mr. **Miller**. Uncertain, at best, to be sure. The full amount of money in these kinds of situations would rarely be recovered if it is nondischargeable. I would not be frank with you if I stated otherwise.

But some of it can be recovered. In those instances, it should be, particularly in the criminal justice restitution area. Also, as my colleague from Kentucky pointed out, the ability of defendants to have this as a remedy and to have it as a safe harbor is an important bargaining tool in any kind of negotiation and a most inappropriate one to be removed by this legislation.

Senator **Grassley**. I would like to have our other witnesses comment on that.

Mr. **Kelly**. Senator, I could almost guarantee that if anything can be guaranteed in life based on my 19 years of experience as a prosecutor that when a person is placed on probation and court orders as a condition of that probation that restitution is to be made, and either the defendant neglects to pay the restitution or only makes partial payment and a violation of probation hearing is scheduled and the court finds that a violation has occurred. In almost the total number of cases, the person, when faced with the proposition of going to jail or completing the restitution, makes the restitution. It is amazing how the money just seems to appear.

Senator **Grassley**. Mr. Siemens.

Mr. **Siemens**. It would be difficult in many cases to collect the money, but it does give the State the opportunity to make that attempt on behalf of the consumers. In many cases, these consumer fraud defendants are not down and out living in a shack type of folks. After the judgment is entered, they go back to business if they are selling subscriptions, they go back to selling subscriptions. If they have been running a business, they generally go back to running the same type of business they have run in the past. If we have a judgment that we can enforce, if they have any income or assets at a later date, we would like to have to opportunity to try on behalf of consumers to collect that judgment.

Senator **Grassley**. Senator Heflin, I would be happy to break and let you interrupt here if you have a statement or questions.

STATEMENT OF HON. HOWELL HEFLIN, A U.S. SENATOR FROM THE STATE OF ALABAMA

Senator **Heflin**. Thank you, Mr. Chairman.

I do not have any opening statement. I have been tied up with this impeachment matter. I have not really had time to focus on this. I am just looking at it right now.

Looking at the language, something in regard to distribution by a governmental entity raises a flag of caution about that. But I was wondering whether or not in distribution it says as a result of violation of State law by a debtor, or as a result of a consent decree. I am looking to see if that has a possible width to it that might encompass things that you are not presently thinking about.

The thing that comes to my mind is a court on interpleader. Of course, the money is paid into court on interpleader. I just wondered what is the distribution is? Would somebody explain that to me. I am a little fearful of that language as to how far it might go.

I do not have any substantial objections right now. I have not had time to think about potential situations that could arise. But what is the court distribution generally aimed at in this section 10? The section 10 listed 10 there.

Mr. MILLER. Yes, sir. The distribution really looks toward the concept of State government seeking restitution for its citizens as part of State law. The two main areas that are looked toward are when the State government attempts to get restitution from those who violate our criminal law—and now more and more criminal restitution programs and obligations are being implemented and have been successful.

The other major area where States seek restitution is in the area of consumer fraud where an attorney general's office would get a consumer fraud judgment and as a major part of that effort, seek restitution for its citizens who have been abused by that fraud.

Senator HEFLIN. In other words, you'd make nondischargeable the debt that arises from a claim which requires the debtor to make restitution to a governmental entity as a result of the consent decree? Is there any danger that that encompasses things that you did not intend it to encompass?

Mr. MILLER. I certainly would hope not. The main ones we are concerned about are those two and also some environmental orders that have been avoided now by debtors by going into bankruptcy. The State governments and their subdivisions are not generally involved in seeking restitution for citizens. It is a somewhat extraordinary remedy that grew up largely in the 1960's concerning consumer fraud and largely in the 1970's and 1980's concerning violations of the criminal law.

Most of the time, State government acts directly on individuals by trying to enforce the law and to take care of illegal conduct. Restitution is generally not our business. But it is in those two particular areas and it is important in our judgment.

Senator HEFLIN. I guess that language just strikes me as exceptionally broad and it might encompass some claims or debts that are paid into court for distribution pursuant to a consent decree that would then be allowed to be dischargeable. I do not really know right now. I just think we ought to give a little thought to whether it needs some restrictive language to effect the intended result.

Mr. MILLER. I had the same reaction as you when I first read it. But I have not been able to think of anything that would, as a practical matter, go further than we wanted. It is clear that we do want, and we think it is appropriate for us to have, relief in the consumer, criminal and environmental areas, however.

Senator GRASSLEY. Thank you, Senator Heflin.

I would like to ask Mr. Kelly if you could tell us the prospects for reversing the *Robinson* case in the Supreme Court.

Mr. KELLY. One is always optimistic in litigation, but one learns as a trial lawyer never to predict the outcome of that litigation. Obviously, if we are successful and the Court holds that criminal restitution is not a dischargeable debt, the Act would still be important and I would still urge its passage as it would address both civil restitution and obviously criminal restitution. If we lose, your bill is the only remedy.

Senator **Grassley**. I have about six more questions, but because of time, I am going to submit them in writing and if you could get responses like in a week or 10 days if you could, please, because we would like to get the record printed if we can.

Mr. **Miller**. Or we can do it sooner, if you like, Senator. We know that time is of the essence as you near the close of the session. We are eternally optimistic about this legislation in the closing weeks. So we will respond within a day or two.

Senator **Heflin**. Why are you submitting "as a result of a violation of State law by the debtor?" Why do you omit Federal law?

Mr. **Miller**. Pardon, Senator.

Senator **Heflin**. I read your language here toward the end of line 12, "as a result of a violation of State law by the debtor." Why do you exclude Federal law?

Mr. **Miller**. We probably should not. We probably should include Federal law. And I think there will be some witnesses on that issue today.

Senator **Grassley**. The next witness is going to address that point.

We will then submit those to you right away.

Thank you for your time here, but most importantly thank you for your leadership on behalf of the people you represent. And also for the support of your colleagues in this effort, particularly those 16 who signed the letter addressed to me.

Thank you very much.

I am pleased to call our next witness, the Honorable Gerald Tjoflat of the 11th circuit on behalf of the Judicial Conference of the United States.

STATEMENT OF HON. GERALD BARD TJOFLAT, JUDGE, U.S. COURT OF APPEALS FOR THE 11TH CIRCUIT, ACCOMPANIED BY FRANCIS F. SZCZEBAK, CHIEF, DIVISION OF BANKRUPTCY, ADMINISTRATIVE OFFICE OF THE U.S. COURTS, AND CHRISTY E. MASSIE, COUNSEL, LEGISLATIVE AFFAIRS, ADMINISTRATIVE OFFICE OF THE U.S. COURTS

Judge **Tjoflat**. Good morning, Mr. Chairman and Senator Heflin.

With me are Christy Massie, who is with the Administrative Office in the Legislative Affairs Division and Frank Szczebak, who is Chief of the Division of Bankruptcy in the Administrative Office.

I have filed a statement and before I would like to have it adopted except for a paragraph of the statement which appears on pages 7 and 8 which I would like deleted because it does not address a problem that I now perceive to be before this committee. So, with your permission, Mr. Chairman, I will delete from my written statement paragraph No. 9 which appears on pages 7 and 8, if you will just cross that paragraph out.

Let me approach this subject if I may from a criminal point of view versus a civil law point of view. This bill or this amendment, as drafted, in my judgment reading it, it says "to the extent that such debt arises from a judgment or consent decree entered in a court of record." That would include any court of record, Federal or State. And would include any judgment, civil or criminal.

"* * * existing at the time of filing or thereafter rendered, or to the extent that such debt arises from a claim requiring the debtor to make restitution to, or for the benefit of, or for distribution by a governmental entity as a result of a result of State law by the debtor." That would embrace any claim, whether it be founded on violation of criminal law or civil law involving the State in which the State is parentis patriae I suppose representing some victims. Then it says—I am interlineating—"to the extent that such debt arise from, or as a result, of the consent decree." So, I would assume the bill as drafted would involve the violation of any consent decree, which I suppose one side or another is seeking to enforce the consent decree through the court's contempt power, Federal or State. As I read the bill now, it embraces in first phrase any judgment of consent decree in a court of record, Federal or State, civil or criminal.

In the next clause, from a claim requiring—these are unadjudicated claims—that result from a violation of State law or result from the violation of a consent decree. The concern of the Federal judiciary is essentially in the criminal law area. In 1982, the Congress passed the Victim and Witness Protection Act, which requires district judges in all title 18 cases and some other cases, to take into account damage and injury sustained by victims and to enter orders of restitution after taking into account all financial aspects relating to the victims, the defendant's family, et cetera, to enter an order of restitution. A district judge, since the passage of that statute, must order restitution unless he finds on the record reasons for not ordering restitution.

In 1984, as you know, the Comprehensive Crime Control Act was passed, which, in title II, incorporated the Sentencing Reform Act of 1984, which had been in legislative debate for 15 years or so. The Sentencing Reform Act of 1984 incorporates in section 3556 of title 18 the entire Victim and Witness Protection Act. When the Sentencing Reform Act takes effect that is the guideline sentencing appellate review provision, where judges will sentence pursuant to Sentencing Commission guidelines, that act will take affect for our purposes on November 1 of next year. You have extended the time for the Sentencing Commission to submit to the Congress its guidelines which will lay on your table for 6 months unless you change them.

Senator **Heflin**. Horrible.

Judge **Tjoflat**. In any event, on November 1 we have a new sentencing law where judges will sentence pursuant to guidelines and there will be appellate review of sentencing.

At this moment, the Victim and Witness Protection Act of 1982 is in affect. So judges are entering restitution orders in sentencing offenders. Beginning November 1, 1987, in every felony case in which an offender is placed on probation be it a corporation or an individual, the district judge must either enter an order of restitution as a condition of probation, a fine as a condition of probation, or community service as a condition of probation. So that under the new law restitution orders will be enforced—the maximum term of probation is 5 years—through the court's power to revoke probation if you do not pay the restitution order. In all events, the restitution order, whether or not it is made a condition of probation, will be the same thing as a civil judgment which can be collected by the party in whose favor the judgment is entered through any means available to a judgment creditor at law.

Under the present, and I agree with Judge Mansfield, the way the Bankruptcy Act is now drafted, a Federal restitution order entered as a criminal sanction is not accepted. It is dischargeable. The act only relates to fines insofar as exceptions are concerned. We very much need an explicit provision in the bankruptcy law, which would except from dischargeability a criminal sanction in the form of a restitution order. Otherwise, you have an unfortunate situation. For example, a district judge, sentencing under these guidelines, has a corporation before it in a massive mail fraud case or it can be five criminal cases or just most any kind of criminal case under the code, enters an order of restitution either directly to victims or to some ombudsman if you have a mass number of victims and small amounts of damages, for distribution. Enters a restitution order, makes it a condition of probation, perhaps enters it against a corporation and against its principal officers or what-have-you, and the individuals, for example, repair immediately to the bankruptcy court and under chapter 7 are adjudicated bankrupt in the sanction is obliterated, because the judgment of restitution is discharged. It leaves the judge with the individual perhaps on probation and no sanction to be imposed. That would be a catastrophic result in our judgment.

This proposed legislation does nothing about speaking to chapter 11. We think that criminal sanctions in the form of restitution orders ought to be preferred and not in any way compromised in a chapter 11 reorganization, for example.

The same is true with a chapter 13 debtor, who has committed a Federal crime who is out on probation and is ordered to make restitution. We must bear in mind that when a district judge under the Victim and Witness Protection Act as it is now incorporated in the Crime Control and the Sentencing Reform Act and will be under this guideline system, enters that restitution order, he is made an exhausted examination of the ability of the defendant to pay. These are not just off-the-cuff orders that are entered.

You also have identifiable victims who have suffered identifiable injury. It is true that when the judge enters that order and you can tailor the restitution order any way you may want to. It may be in installments, for example, if it is a wage earner so much a week. It might be a pittance, but it is so much a week. Technically, the order might, if you lumped all the debts up, it may render the defendant insolvent and so he repairs to the bankruptcy court.

That is essentially our position. An explicit provision be made excepting from dischargeability, restitution orders entered pursuant to title 18, section 3556.

Senator GRASSLEY. Would you let me interrupt. We do have a vote on the floor, and it is my understanding it is on the "buy American" bill dealing with cement and steel. We will have to leave right now. But unless we have what we call "back-to-back" votes, I will be right back here to finish with the questions. But if we do have back-to-back votes, I will call and ask my staff to do it, because I have another appointment at a quarter to 12. I will not be able to say goodbye for sure.

Senator HEFLIN. Before we disband, let me ask you to look at this language, Judge.

Judge TJOFLAT. Yes, sir.

Senator HEFLIN. See if under a class action, a suit might be filed. Let us say General Motors makes a defective part which is in violation of the State law, and they are required to pay into court for claims. Does this entail that?

Judge TJOFLAT. They would be excepted.

Senator HEFLIN. Let us take Texaco. Texaco gets a judgment violation of a State antitrust law. It goes into bankruptcy. I do not think the word restitution should be defined as not to include compensatory or punitive damages arising out of the civil lawsuit.

Judge TJOFLAT. Senator, the tough question that you have to decide when it comes to violation of the common law, let us say, or statutes, like consumer fraud laws, which require less burden of proof than the old common fraud and deceit and which provide for class actions. The question you have to decide is whether you want to prefer those tort claims to other kinds of claims held by people with respect to the debtor. And as the legislation is now drawn, it would embrace any class action that I could figure. I think any class action under any State law.

Senator HEFLIN. It would include all of that.

Judge TJOFLAT. Yes. Yes, sir.

[Recess.]

Senator GRASSLEY. Judge Tjoflat, there has been some discussion in the absence while we were voting about how the bill introduced might be rewritten to some extent. I would appreciate for the record some discussion of that if you could.

Judge TJOFLAT. Mr. Chairman, I would approach the bill this way:

I would have an explicit subparagraph that dealt only with criminal fines imposed in Federal court. This is an example of language. You might have subparagraph 10. These are items that are nondischargeable. "To the extent that such debt was created by an order of restitution entered under 18 U.S.C., section 3556." That would say it all about a Federal criminal restitution order.

You might have another section, a next number, would address restitution orders entered by State courts to sanction the commission of a crime, which the defendant has been adjudicated guilty and it is part of the sentence. I would accept those.

This is policy call from the State level, which is little different from ours. We need one dealing with Federal crimes, because without it, it frustrates the implementation of the Sentencing Reform Act of 1984. But it seems that from a policy point of view, somebody who has been the victim of a State crime, one could reason it seems to me quite readily that they ought to be preferred over just some other creditor who was doing business with the criminal company or individual.

We should have one on Federal crimes, one of State crimes, and then, I think, what the States attorneys generals are really driving at are situations in which the States rather than pursuing people who have committed commercial crimes, fraud and deceit, pyramid companies and things like that who are literally raping citizens in a State, the injury a given citizen might be small and to charge these people under the common law fraud and deceit crime statutes would be just too cumbersome so the States pass these consumer fraud laws. What they did was they used the same elements. In other words, the individual still is a criminal, committed a crime, but they lowered the burden of proof from beyond reasonable doubt to clear and convincing or some something else, and the swap was that since the offender is no longer subject to being imprisoned for doing what he did, will let a little less burden be carried by the State. Then the statute created a situation which the attorney general would be the ombudsman or the collector of all these claims.

I think that is what they are driving at. If it is the will of the Congress somehow to preserve these victims quasi-criminal conduct, then I would have a separate provision for them.

But I would eliminate and now I am now in your domain completely, anybody who holds a judgment, because that would encourage who had a claim against the debtor to reduce it to judgment just as quickly as possible. You would just flood the courts, State and Federal, with people wanting to get a judgment against somebody who is in tough financial condition and that would never be discharged. I do not think anybody really intends that.

Senator **Grassley**. Well, I would like to say in summary I have one or two questions I am going to submit in writing.

Judge **Tjoflat**. I would say that with your permission, we would like to submit some language.

Senator **Grassley**. I guess I was going to say that to you, that except for a couple of questions that I am going to submit to you in writing for answers, I would appreciate very much having our staffs work on the language.

I want to thank you very much for your participation. Of course, I want to thank all of our witnesses for their fine testimony this morning.

I am very convinced, maybe more so now than ever, that we needed to act in this area. This is based upon the record that we have built, and we have heard this morning. I, of course, appreciate that the purpose of the Bankruptcy Code to give every debtor a fresh start, but I do not think that protection ought to be given to the less than honest debtors either. That has been made abundantly clear by our first panel.

We in the Congress talk a great deal about fighting fraud. I have spent a great deal of my time in the Senate doing that. But this is an area where we ought to fight more aggressively. The States want to aggressively do their part to protect their citizens from fraud as well as we do here at the Federal level.

I want to encourage the States to fight fraud, but we must give them the tools to do it. Right now they tend to fighting with one hand tied behind their backs.

[The prepared statement of Judge Tjoflat follows:]

PREPARED STATEMENT

OF

HONORABLE GERALD BARD TJOFLAT
JUDGE
UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

ON BEHALF OF

THE JUDICIAL CONFERENCE OF THE UNITED STATES

Mr Chairman and Members of the Subcommittee:

My name is Gerald Bard Tjoflat. I am a judge of the United States Court of Appeals for the Eleventh Circuit. I appear before you today in my capacity as Chairman of the Committee on the Administration of the Probation System of the Judicial Conference of the United States. I appreciate the opportunity to appear before this subcommittee to testify on behalf of the Judicial Conference of the United States on S. 2531.

At the March 1986 Proceedings of the Judicial Conference of the United States, the Conference evaluated a similar legislative proposal, H.R. 3742, which provided that all court-ordered restitution payments be nondischargeable in bankruptcy proceedings, and approved the proposal only as it applies to Federal restitution orders. The Judicial Conference further concluded that restitution orders imposed in Federal criminal cases should not be subject to reexamination in bankruptcy proceedings. The application of the bankruptcy laws of the United States to State restitution orders, on the other hand, is a policy determination for Congress.

Restitution is defined as "an act of restoring; restoration; restoration of anything to its rightful owner; the act of making good or giving equivalent for any loss, damage or injury; and indemnification." Black's Law Dictionary 1180 (5th Ed. 1979). The principle of restitution holds that "whatever else the sanctioning power of society does to punish its wrongdoers, it should also insure that the wrongdoer is required to the degree possible to restore his victim to his or her prior state of well-being." S. Rep. No. 97-532, 97th Cong., 2d Sess. 30 (1982). Prior to 1982, Federal judges could order restitution only as a condition of a sentence of probation. Restitution was infrequently used and indifferently enforced. The victim was, in essence, "forgotten" in our system of criminal justice, with its concentration on the rights of the accused.

Victim and Witness Protection Act of 1982

The rights of victims were first addressed in the Victim and Witness Protection Act of 1982. The Act's stated purpose was to make the criminal justice system more sensitive to crime victims and witnesses. The Act permitted a court for the first time to order restitution in lieu of or in addition to any other penalty imposed. If the court did not impose restitution, or imposed only partial restitution, then the Act required the court to state on the record the reason why full restitution was not ordered. The victim or the United States could enforce an order of restitution in the same manner as a civil judgment. If the offender was placed on probation or parole, compliance with an order of restitution became a mandatory condition thereof. With passage of this bill, Congress took a significant step forward in recognizing the need to defend the rights of victims and expressing its intent to protect those rights.

The Comprehensive Crime Control Act of 1984 and the Criminal Fine Enforcement Act of 1984

In 1984, Congress reaffirmed its intention to protect and defend the rights of victims in the Comprehensive Crime Control Act of 1984, specifically in Title II - the Sentencing Reform Act of 1984. The Sentencing Reform Act of 1984 carries forward the restitution provisions enacted in the Victim and Witness Protection Act. In addition, the Act requires the newly created United States Sentencing Commission to issue policy statements concerning the appropriate use of orders of restitution. Finally, the Act requires that if a person convicted of a felony is sentenced to a term of probation, a condition of that probation must be that he pay a fine or restitution or perform community service.

Shortly after passage and enactment of the Comprehensive Crime Control Act, a closely related bill, the Criminal Fine Enforcement Act of 1984, was passed and enacted. In section 3622 of title 18, the Criminal Fine Enforcement Act sets forth those factors that a judge must consider when deciding whether to impose a fine and, if a fine is to be imposed, the amount of the fine. These factors are drawn from from the Victim and Witness Protection Act of 1982 and the Sentencing Reform Act of 1984. The fifth factor, which section 3622 directs the judge to consider, is any pecuniary loss inflicted upon others as a result of the offense. This factor is also required to be considered in deciding whether to impose restitution. The sixth factor that the judge must consider is whether restitution is to be ordered and, if so, the amount of restitution. The committee report states that "[t]his factor is necessary because of the provision in section 3622(b) that gives restitution priority over a fine.". H.R. Rep. No. 98-906, 98th Cong., 2d Sess. 14 (1984). Section 3622(b) provides that the judge may order a convicted offender to pay a fine "only to the extent that such fine or penalty will not impair the defendant's ability to make restitution". 18 U.S.C. § 3622(b). Conversely, there is no statutory requirement that, in deciding whether to order restitution, the judge consider whether the defendant will be fined or the amount of any fine.

We believe, therefore, that Congress' decision to give restitution a priority over fines and the overwhelming evidence of Congress' intent to protect the rights of victims permeates the entire legislative history of restitution.

Restitution and Bankruptcy

The basic concept of the Bankruptcy Code, in title 11, United States Code, is that all debts which pre-date the filing of a bankruptcy petition are discharged unless the debts are specifically excepted from discharge under section 523 or the discharge of all debts is denied under section 727. While the Bankruptcy Code specifically prohibits the discharge of court-ordered fines, a few courts have interpreted the statutes to find no specific prohibition against the discharge of restitution. These courts have considered a restitution order a "debt" with no exception within the meaning of the Bankruptcy Code, thus differentiating between fines and restitution and inferring a priority for fines over restitution. This priority goes totally against the entire legislative history of restitution in relation to fines.

Since restitution is a sentencing option in the same manner as a criminal fine, the dischargeability may be perceived as a limitation on the district judge's options when sentencing a criminal offender. This situation creates the following problems:

1. It thwarts the basic purposes of all three pieces of legislation dealing with restitution, especially the Sentencing Reform Act of 1984.
2. It throws a "wild card" into the policy formulations of the United States Sentencing Commission.
3. In the case of a felony, if restitution is imposed as a mandatory condition of probation, then revocation of probation is possible unless the court modifies the conditions of probation. In relation to supervised release, if restitution is a mandatory condition of release, then contempt of court is possible since the court cannot resentence the defendant. If a defendant's obligation to make restitution is discharged in bankruptcy proceedings, the question arises whether the

sentencing judge can sanction the defendant's subsequent refusal to make the ordered restitution by revoking his probation or citing him for contempt for violating a condition (making restitution) of supervised release.

4. Under the Bankruptcy Amendments and Federal Judgeship Act of 1984, a bankruptcy judge is an officer of the district court and, as such, the bankruptcy judge's decisions may be appealed to a district judge pursuant to 28 U.S.C. § 157. In addition, the district court, under the same section, may withdraw, in whole or in part, any case or proceeding referred to a bankruptcy judge. If a bankruptcy judge can discharge a defendant's obligation to make restitution, we create the appearance in the minds of the public and the victim that the bankruptcy judge is second-guessing the criminal justice system as to the appropriateness of the restitution sanction. The criminal sentence of a district judge should not be subject to reexamination in a bankruptcy proceeding.

5. Although a majority of courts that have considered the issue have held that an order of restitution is not dischargeable in bankruptcy and only In re Brown, 39 B.R. 820 (Bankr. M.D. Tenn. 1984) and In re Robinson, 776 F.2d 30 (2nd Cir. 1985), have concluded that restitution is a debt with no exception under the Bankruptcy Code and is dischargeable, the issue is by no means settled. There still exists the possibility that a criminal offender, individual or corporate, could use the bankruptcy laws of the United States to escape the sentence of the district court. Consider the options available to the court for the sentencing of a corporate offender — a fine and/or restitution. The sentencing court finds the defendant has the ability to pay over a period of time a sizable fine and restitution. But, taken as a whole, the amount of the fine and/or restitution could render the defendant technically insolvent in a bankruptcy sense. The offender after being sentenced, could file for bankruptcy immediately and have the order for restitution discharged, thus leaving the offender with only a fine which could be written off as a cost of doing business. Such a result would be unconscionable. We believe that the "fresh start" envisioned by the

Bankruptcy Code was not intended to release the offender from criminal sanctions. I am in total agreement with Judge Mansfield in his concurring opinion in the Robinson case that Congress should remedy this loophole.

6. It may be argued that the victim, whether an individual or a corporate or governmental entity, has a right to file a timely objection to discharge in a bankruptcy proceeding. If the principal aim of restitution is to make the victim whole, then this argument has some merit. But in many Federal cases the United States collects for the victim and the United States would have no standing to object to discharge of the underlying debt. In addition, if restitution is a condition of probation, then fundamental to the imposition of probation is the belief that its conditions will punish the offender and also, perhaps, result in the rehabilitation of the probationer at no cost to public safety. The focus of any probation condition is on the offender. A district judge should be able to require an offender, as a condition of probation, to make restitution to his victim for losses caused by the offense for which he was convicted, even when the debt occasioned by the offense has been discharged. Making the victim whole is thought to be rehabilitative in effect. Just because the debt has been extinguished does not mean that the victim's loss has been extinguished.

7. S. 2351 provides that only those orders of restitution to, for the benefit of, or for distribution by a government entity can be excepted from discharge. This does not seem to allow an order of restitution payable to an individual victim to be nondischargeable. This puts the State or Federal government in the collection business. This would also tend to require a judge to make every order of restitution, even for individual victims, collectible by the government and would effectively eliminate the option of payment directly to the victim. All Federal restitution orders should be excepted from discharge.

8. S. 2531 only addresses Chapter 7 and Chapter 11 discharge. I would point out to the subcommittee that, consequently, this legislation would not affect Chapter 11 or Chapter 13 reorganizations.

Conclusion

In the passage of criminal laws to protect and defend the rights of victims, there is a clear Congressional intent to give priority to restitution, especially over the imposition of a fine. It makes little sense to except from discharge in bankruptcy a debt owed as a criminal fine and to not except a debt owed as restitution. Therefore, the Judiciary respectfully requests that any legislation, such as S. 2531, to make restitution orders nondischargeable in bankruptcy include all Federal restitution orders, including those payable to the victim, and would defer to Congress as to the nondischargeability of State restitution orders.

Senator GRASSLEY. With that, I want to adjourn the hearing and to say that the record will remain open for 1 week for additional materials or anybody who wants to correct or add to any of the record. That includes the witnesses as well as any of the Members who are not here, who each panel might expect questions from other people.

Thank you very much. Meeting adjourned.

[Whereupon, at 11:43 a.m., the subcommittee adjourned at the call of the Chair.]

APPENDIX

CORRESPONDENCE

Judge's Chambers
United States Bankruptcy Court
Eastern District of Tennessee

Post Office Box 1189
Chattanooga, Tenn. 37401

Ralph H. Kelley
Bankruptcy Judge

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615-266-2185
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September 16, 1986

Mr. Samuel J. Gerdano
Counsel, Subcommittee on Administrative
Practice and Procedure
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Gerdano:

Thank you for forwarding me a copy of S.2531, a bill to make nondischargeable any debt arising from a judgment or consent decree requiring an individual debtor to make restitution as a result of a violation of State law.

You also attached remarks from Senator Grassley in which he says that the bill is designed to close a "loophole" which allows "convicted felons and consumer ripoff artists. . ." to receive a discharge in bankruptcy.

The bill appears to have been prompted by the decisions Robinson v. McGuigan, 776 F.2d 30 (2d Cir. 1985) and In re Cannon, 741 F.2d 1139 (8th Cir. 1984) (Missouri v. Cannon). An analysis of those cases is attached to my letter.

The bankruptcy law is not designed to give crooks and others guilty of fraudulent conduct a discharge in bankruptcy. It was designed to give an honest debtor a new start.

In the Cannon case, it was the state which filed suit and not the injured consumers. The state court ordered restitution to the consumers, rather than to the state attorney general. The state statutes did not provide that the attorney general could enforce the resitution order for the consumers. As a result, the restitution was not a debt owed to the attorney general and he could not enforce the restitution order. This problem could be cured by amending the state law.

In the Robinson case the problem was that the government did not file a timely complaint seeking to have the debt excepted from discharge, even though it had notice. The court of appeals pointed out that if the state had filed a timely complaint the debt probably would have been excepted from discharge based on the debtor's guilty plea to larceny.

The bill, S.2531, would appear to be broad enough that any judgment or consent decree for violation of state law would be nondischargeable. This may include taxes, penalties, or items not at all concerned with fraud or dishonesty, which always have been grounds for excepting debts from discharge.

I agree with what Senator Grassley is attempting to accomplish, but I believe that you should consider tightening the language. I have also enclosed a more detailed analysis of the problem.

Best wishes.

Sincerely,

Ralph H Kelley

Ralph H. Kelley
United States Bankruptcy Judge

RHK/njf

Enclosure

* * *

CASES

ROBINSON V. McGUIGAN, 776 F.2d 30 (2d Cir. 1985).

The creditor in this case was the state from which the debtor had obtained welfare benefits by fraud. The debtor pled guilty in state court to larceny. As a condition of probation, she was ordered to repay the state the money wrongfully received. She filed a chapter 7 bankruptcy. The state was notified but failed to file a dischargeability complaint under §523(a)(2) or (4) within the time allowed. Several years later the state took the position that the restitution debt was still owed. The debtor brought suit to have the debt held discharged. The court of appeals held:

(1) A criminal restitution order is a debt under the bankruptcy laws and may be discharged.

(2) If the state had filed a timely complaint under §523(a)(2) or (a)(4), the debt probably would have been excepted from discharge on the basis of the debtor's admitted larceny or on the basis of fraud or false pretenses. Since the state failed to file a timely complaint under those sections, the debt was nondischargeable, if at all, only under §523(a)(7).

(3) The debt was not excepted from discharge under §523(a)(7). It excepts from discharge fines, penalties, or forfeitures to or for the benefit of a governmental entity, except to the extent they are for actual pecuniary loss. The restitution order was for actual pecuniary loss and was discharged.

IN RE CANNON, 741 F.2d 1139 (8th Cir. 1984) (Missouri v. Cannon).

The state filed suit against the debtor under the Merchandising Practices Act and the debtor was found to have violated it by making fraudulent representations. The court ordered the debtor to make restitution to eight specific individuals. The court of appeals held that the state could not enforce the restitution order because the state statutes did not allow it. Thus, the state was not the creditor to whom the debt was owed and could not have the debt excepted from discharge.

ANALYSIS

It appears that almost all criminal restitution orders are already nondischargeable under §523(a)(2), (4), or (6). The second circuit pointed out in the Robinson case that the state had an easy nondischargeability case if it had filed a timely complaint under §523(a)(2) or (4). The state's problem was not caused by the lack of an appropriate exception to discharge but by the requirement that a complaint be filed shortly after the bankruptcy case was filed by the debtor. The concurring judge (Judge Mansfield) goes so far as to say that he does not like this rule. He would allow the state to enforce restitution orders under an amendment to §523(a)(7), which is not subject to the time limitation on when a complaint must be filed. The judge did not discuss why it should make a difference between creditors in essentially the same position whether one has a criminal restitution order while the other only has a civil judgment for fraud, false pretenses, false representations, assault, or some other wrong that is already nondischargeable. Distinguishing between whether the person harmed does or does not have a criminal restitution order would put a premium on creditors proceeding through the criminal courts as a method of collecting their debts. The bankruptcy courts have already had much difficulty with creditors who have received bad checks and automatically go to the criminal courts as a method of collecting.

The question of whether only the crime victim could enforce the order or also the attorney general depends greatly on state law, which was the basis of the eighth circuit's decision in Cannon. The restitution order did not give the attorney general the right to enforce it and neither did the state law. Thus, the attorney general was not the creditor who was entitled to have the debt held nondischargeable. I know of no reason why an attorney general in this situation cannot be made a creditor by amending the state law or by the restitution order. The dischargeability suit would then be brought by the state for the benefit of the crime victim. If there is a problem with this, the Bankruptcy Code could possibly be amended to address it.

Restitution orders under consumer protection laws present a different problem. The attorney generals point out in their letter to Senator Grassley that consumer fraud is not necessarily within the present exception to discharge in §523(a)(2). I suspect that it usually is within the exception, but as the attorney generals point out, the application of the res judicata and collateral estoppel doctrines means that relitigation may be required. There may be room for amendments to the Code with regard to the dischargeability of debts under state consumer fraud stautes, and with regard to who can enforce such debts in bankruptcy.

The enforcement of state environmental protection laws against debtors in bankruptcy is already a troubled area of the law, the problem having reached the U. S. Supreme Court in Ohio v. Kovacs, 469 U.S. 274, 105 S.Ct. 705, 83 L.Ed.2d 649 (1985) and Midlantic National Bank v. New Jersey Department of Environmental Protection, 106 S.Ct. 755, 88 L.Ed.2d 859, 54 U.S.L.W. 4138 (1986).

The question of dischargeability of fines or penalties for violation of environmental protection laws apparently is dealt with under §523(a)(7), which allows discharge of a fine or penalty if it is not for actual pecuniary loss. This could be a problem. Congress could decide to make such fines or penalties nondischargeable even if they are for actual pecuniary loss. Whatever Congress decides on this point would equally apply to dischargeability of debts for reimbursement of clean-up costs that the state or federal government have paid.

Restitution for the victims of crimes, restitution for the victims of consumer fraud, and the enforcement of state environmental protection laws raise three distinct problems in the bankruptcy context. The proposed amendment does not differentiate. Furthermore, it is broad enough to include any judgment, consent decree, or restitution order granted to the state for the violation of state law, without regard to whether the violation involved wrongdoing of the kind that has traditionally been the basis for making a debt nondischargeable. The proposed amendment could even apply to debts for the failure to pay taxes; the dischargeability of tax debts is dealt with separately by Bankruptcy Code §523(a)(1).

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September 22, 1986

Senator Charles E. Grassley
℅ Mr. Sam Giardino
Counsel to the Committee on Administrative
Practice and Procedure
Hart Senate Office Building, Room 229
Washington, D.C. 20510

Dear Senator Grassley:

It is with pleasure that I submit the following comments in support of Senate Bill 2531 for the record.

In the enforcement of Chapter 407, Missouri's Merchandising Practices Act, this office has encountered serious problems in its efforts to recover monies for consumer victims. These hindrances stem from the various provisions of the Bankruptcy Code that effectively protect a debtor from non-bankruptcy litigation.

A person who has committed consumer fraud first looks to the automatic stay provision, 11 U.S.C., Section 362, which halts any litigation unless that litigation fits specific exemptions set out therein. Although the Attorney General has been permitted to continue in litigation to receive injunctive relief, the bankruptcy courts differ in their interpretation of the further right under 11 U.S.C. Section 362(b)(4) to allow the state court to determine an award of restitution. Our St. Louis Office is presently in litigation against one Howard Fisher, a consumer fraud suit with twelve hundred potential victims at an alleged loss of five thousand dollars apiece. After a preliminary injunction was entered against the defendant in August of 1985, he filed bankruptcy in the District Court of Phoenix, Arizona. Historically, that particular Bankruptcy Court has prohibited a consumer fraud suit from continuing to determine the restitution owed consumers. See In Re Koonce Development Corp., Inc., No. B83-300 (Bkrtcy. Ct., Ariz.). Although other bankruptcy courts may allow a determination of the restitution by a state court, the only uniform rule is that the Attorney General must then turn to the Bankruptcy Court for any enforcement.

To seek restitution within the Bankruptcy Code, one must be a "creditor" under 11 U.S.C. Section 101. The Missouri Legislature, in revising Chapter 407, changed the restitution section, Section 407.100 RSMo 1978, to make restitution payable to the State of Missouri. This change has been recently interpreted to affect only those transactions by consumers that have occurred after May 31, 1985. See In Re Danzig, No. 86-1568C(1) (Bkrtcy. Ct. MO 1985). Therefore, the Attorney General is effectively prevented from pursuing fraud through the Bankruptcy Court if the transaction that gave rise to the fraud occurred earlier than the above date.

Our next obstacle confronts my attorneys when they seek to have removed from the Bankruptcy Court the debts owed the consumers under 11 U.S.C. 523 (a)(2) that excepts from discharge those debts wherein the debtor has obtained "...money, property, services...by (A) false pretenses, a false representation, or actual fraud...". The case law is uniform in declaring that in the case of misrepresentation, a knowingly intentional statement with reliance by the victim resulting in an ascertainable loss must be proved. In Re Collins, 28 B.R. 244 (Bkrtcy. Ct. Oklahoma 1983). However, state consumer laws often do not require such intent or reliance. In Missouri, the courts have ruled that the various elements of common law fraud such as reliance and intent are not applicable to the Merchandising Practices Act. Missouri ex rel. Asncroft v. Marketing Unlimited of America, Inc. 613 S.W. 2d 440, 445 (Mo. App. 1981).

The dissimilarity of proof requirements between state consumer law and the bankruptcy nondischargeability provision result in the likelihood that a second trial in the bankruptcy court will be necessary, although the Attorney General may have litigated his state consumer suit to a successful conclusion, with an order entered for injunctive relief and restitution. Schwartz v. Renville Farmers Co-op Credit Union, 44 B.R. 266 (D.C. Minn. 1984). The doctrine of collateral estoppel will only be applied when the precise issue before the Bankruptcy Court was fully litigated in the state court with substantially similar elements of fraud or misrepresentation proved, the findings were essential, and the factual findings satisfy all elements of 11 U.S.C. Section 523 (a)(2)(A). In Re Shacket, 26 B.R. 930 (Bkrtcy. Ct., Mich. 1983).

As this brief essay points out, bankruptcy can be an effective tool in the hands of a defendant facing a suit for a consumer fraud brought by a state Attorney General's Office. Unfortunately, it has been the experience of the Missouri Attorney General that the bankruptcy problem occurs more often in those cases in which the number of affected consumers are great and their individual losses do not justify an individual spending filing and legal fees to contest the dischargeability of the claim.

For the above reasons, I believe that Senate Bill 2531 is an appropriate remedy to the ills I have set out above by severing from the bankruptcy process those debts owed as restitution under a court decree as a result of a state law violation.

WILLIAM L. WEBSTER
Missouri Attorney General

THE COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF THE ATTORNEY GENERAL
ONE ASHBURTON PLACE, BOSTON 02108

FRANCIS X. BELLOTTI
ATTORNEY GENERAL

September 29, 1986

The Honorable Charles E. Grassley
Chairman, Subcommittee on Administrative
Practice & Procedure
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Chairman Grassley:

Regretfully, I was unable to appear before the Subcommittee on September 24, 1986 to testify in support of S. 2531. This bill would make nondischargeable an individual's debt for restitution arising out of an action brought by a state for a violation of law. I submit this letter in lieu of my testimony.

Senate Bill 2531 is intended to eliminate a "loophole" in the U.S. Bankruptcy Code. That loophole currently allows individual debtors to discharge debts owed to the state for restitution. For example, under present law, the debtor may discharge a state court order to reimburse a state for amounts payable to consumers injured by unfair and deceptive business practices. Likewise, the debtor may use bankruptcy to avoid court-ordered environmental clean-up charges or welfare fraud reimbursement.

I believe that the Bankruptcy Code should not permit such debtors to seek refuge in the Bankruptcy Court to discharge payment obligations imposed upon them because of their violation of statutes which protect the public interest. I share this view with many other attorneys general throughout the country who have voted with me, as members of the National Association of Attorneys General, in a resolution urging Congress to close this loophole in the Bankruptcy Code.

In Massachusetts, my office has been confronted several times with individual debtors who have violated state consumer or environmental laws, and then have filed bankruptcy petitions, or threatened to do so, in attempts to avoid paying restitution to consumers or the state. In a $30 million case involving hazardous waste site operators who have repeatedly violated environmental laws, the operators have threatened to file for personal bankruptcy if the Attorney General does not negotiate a settlement with them. Moreover, because restitution owed to the state for consumers is easily dischargeable, consumer attorneys are frequently forced to seek payments from individual defendants in the form of civil penalties, which are not dischargeable, rather than as restitution for the victims of the defendant's unlawful acts. When there is a likelihood of an individual defendant filing for bankruptcy, even if the attorney general successfully prosecutes the state court enforcement action, consumers often lose their opportunity for restitution.

Senate Bill 2531 would restore to the states their rights to collect payments from debtors for wrongs committed against the public interest. The current law is far too generous to those who commit unlawful acts and are ordered by courts to pay for them.

I respectfully urge the Subcommittee to pass S. 2531.

Very truly yours,

Bellotti

FRANCIS X. BELLOTTI
ATTORNEY GENERAL